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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

IN THE MATTER

of

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY,
Debtor.

Nos. 479 and 480

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO,
Petitioner,

vs.

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*

Nos. 481 and 482

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK,
Petitioner,

vs.

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*

Nos. 483 and 484

MISSISSIPPI VALLEY TRUST COMPANY,
Petitioner,

vs.

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*

Nos. 485 and 486

HARRIS TRUST AND SAVINGS BANK,
Petitioner,

vs.

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*

Nos. 487 and 488

THE NEW YORK TRUST COMPANY,
Petitioner,

vs.

THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR PETITIONERS.

Opinions Below.

No opinion was rendered by the District Court. The opinion of the Circuit Court of Appeals (R. 313-326) is reported in 72 F. (2d) 443.

Jurisdiction.

The judgments of the Circuit Court of Appeals were entered July 23, 1934. (R. 327-331, 333-337.) The peti-

tion for certiorari was filed October 22, 1934, and was granted December 3, 1934. (R. 348.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1. Whether a district court, in a proceeding for the reorganization of a railroad under Section 77 of the Bankruptcy Act, has power in a summary proceeding to enjoin the sale by a pledgee of validly pledged collateral, consisting of mortgage bonds (a) of the debtor railroad, and (b) of a subsidiary corporation, when such sale is authorized by the pledge agreement and does not require judicial proceedings.

2. Whether the District Court erred in holding that a sale of the pledged collateral would "prevent the orderly preparation and consummation of a plan of reorganization" and that an injunction against such sale was "necessary for the enforcement of the provisions of Section 77."

3. Whether Section 77, as construed by the courts below, violates the Fifth Amendment by depriving petitioners (the pledgees) of preexisting vested rights to sell the pledged collateral pursuant to the pledge agreements.

4. Whether, in a proceeding under Section 77, a district court sitting in one district may enjoin the sale of collateral validly pledged by the debtor to and held by a pledgee bank which (a) is not a party to the proceeding, (b) is not a resident of or present within such district, and (c) holds the collateral and note secured thereby outside such district.

Statutes Involved.

The pertinent provisions of Section 77 of the Bankruptcy Act (Act of March 3, 1933, c. 204, 47 Stat. 1474; U. S. C. A., Title 11, Sec. 205) and other relevant statutes appear in the Appendix, pp. 91-93, *infra*.

Statement.

On November 22, 1933, in a proceeding under Section 77 of the Bankruptcy Act, entitled "In the Matter of The Chicago, Rock Island and Pacific Railway Company, Debtor" (said company being herein referred to as "Debtor"), the District Court entered an order enjoining these petitioners and Reconstruction Finance Corporation (herein referred to as "R. F. C.") from selling collateral held by each of them as security for promissory notes of the Debtor, until further order of the Court (R. 101-104).

Three of the petitioners (The Chase National Bank of the City of New York, The New York Trust Company and Mississippi Valley Trust Company, referred to herein as the "non-resident banks"), unlike R. F. C. and the other two petitioners (Continental Illinois National Bank and Trust Company of Chicago, and Harris Trust and Savings Bank, referred to herein as the "Chicago banks"), were not and are not residents of or doing business in the Northern District of Illinois (R. 116-119). Neither any of the petitioners, nor R. F. C., was made a party to the proceeding, or was ever served with process. The only notice of the Debtor's petition (pursuant to which the injunction

was issued), received by petitioners or R. F. C., was by registered mail (R. 55-56).

In response to such notice by mail, each of petitioners and R. F. C. appeared specially to object to the jurisdiction of the court over it (R. 68, 70, 71, 72, 73, 75). The R. F. C. and the Chicago banks also each appeared specially to object to the jurisdiction of the court (a) over the subject-matter, and (b) to grant the injunction in a summary proceeding (R. 70, 71, 75).

To obviate the question whether the injunctional order involved a "controversy" or a "proceeding" in bankruptcy,[1] each petitioner and R. F. C. took two appeals from the order—one being allowed by the District Court and the other by the Circuit Court of Appeals (R. 124, 133, 140, 148, 155, 163, 215, 229, 242, 254, 266, 278). The two appeals of each appellant were consolidated for hearing in the Circuit Court of Appeals (R. 287-298). On July 23, 1934, that Court affirmed the injunctional order (R. 313-326) and, none of the appeals being dismissed, entered twelve judgments accordingly (R. 327-338).

The injunction was entered upon the following record:

On June 7, 1933, the Debtor filed in the District Court its original petition, alleging that it was "unable to meet its debts as they mature," and that it desired to effect a plan of reorganization under Section 77 of the Bankruptcy Act

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[1] See *Taylor* v. *Voss*, 271 U. S. 176, 180 *et seq.* (1926); *Bryan* v. *Speakman*, 53 F. (2d) 463, 465 (C. C. A. 5th, 1931).

(R. 2-5). On the same day, the court entered an order approving the petition as properly filed, and directing the Debtor, pending further order, to operate its railroads, subject to supervision of the court (R. 6-10). Thereafter the Debtor conducted its business pursuant to said order until November 22, 1933, on which date the court appointed trustees of the Debtor's property (R. 105-107). By orders entered August 28, 1933, and October 24, 1933, petitions of certain of the Debtor's subsidiaries to effect plans of reorganization under Section 77 in connection with, or as a part of, the plan of reorganization of the Debtor were approved by the District Court (R. 26-28, 97-99).

On September 26, 1933, prior to the appointment of trustees, the Debtor filed in the District Court a petition (R. 37-43) which alleged, in substance, that the Debtor was indebted to R. F. C. in the sum of $13,659,877.58 evidenced by six notes, dated on or prior to April 1, 1933, and due March 1, 1934; that said notes were secured by pledge to R. F. C. of collateral, described in detail, consisting chiefly of mortgage bonds of the Debtor and of its subsidiaries aggregating approximately $40,000,000 in face amount; that all interest on said notes had been paid to the date of the petition, the next instalment being due October 1, 1933; that the Debtor was also indebted to these petitioners in the total face amount of $4,125,000 ($3,866,923.34 after application of deposits by two of petitioners), evidenced by notes payable to the respective petitioners, dated August 1, 1932, and due March 1, 1934, and secured by pledge to each of petitioners of mortgage bonds (a) of the Debtor, and (b) of a subsidiary corporation, in the aggregate face amount of

$14,409,000; that all interest due to date on the notes held by petitioners had been paid, and that by their terms no further interest would be due until February 1, 1934 (R. 40).[2]

From exhibits attached to the Debtor's petition (R. 52-55) it appears that each of the notes held by petitioners provides that it shall become due in case of, among other events, (1) nonpayment of interest, (2) the insolvency of the Debtor, (3) the appointment of a receiver for the Debtor, or (4) nonpayment of interest on any of the Debtor's notes held by R. F. C. (R. 53); and each note provides (R. 54) that:

> "Upon default of any kind hereunder, the payee may sell in * * * New York City, or elsewhere,

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[2] The amounts of petitioners' loans and the collateral securing the same are as follows (R. 39):

		Collateral	
	Amount of Loan	First and Refunding 4% Gold Bonds	St. Paul and Kansas City Short Line 4½% Gold Bonds
Chase National Bank.....	$2,000,000	$3,253,000	$3,956,000
Continental Illinois Bank and Trust Company.....	1,250,000	1,307,000	2,758,000
New York Trust Company	500,000	800,000	1,010,000
Harris Trust and Savings Bank	250,000	405,000	490,000
Mississippi Valley Trust Company	125,000	190,000	240,000
	$4,125,000	$5,955,000	$8,454,000

This total of $4,125,000 was reduced to $3,866,923.34 by application of Debtor's deposits in the Continental and Mississippi Valley banks (R. 40).

The First and Refunding 4% Gold Bonds are mortgage bonds of the Debtor (R. 30, 45, 103). The St. Paul and Kansas City Short Line 4½% Gold Bonds are mortgage bonds of a corporation whose capital stock is owned by the Debtor and there is a statement in the record that they "are guaranteed as to principal and interest by the Debtor" (R. 20).

All the loans were made *with the approval of the Interstate Commerce Commission* (R. 14).

> * * * all or any of the security held for the payment of this note, at any broker's board or at public or private sale, without * * * notice * * * and the payee may be the purchaser of any or all property, rights and/or interests so sold * * * ."

The Debtor's petition alleged further that the value of the collateral securing each of said notes was substantially in excess of the amount of said note; that if the holders of the notes should sell said collateral it would cause a substantial and irreparable loss to the trust estate, and that a forced sale thereof "at the present time * * * *might* result" in a substantial deficiency judgment against the Debtor, and would dilute the respective interests in the trust estate of the holders of the Debtor's bonds, of other creditors, and of the Debtor itself (R. 40-41).

The petition asked for instructions as to the payment of interest due R. F. C. on October 1, 1933 [September 30, 1933; see R. 75-77], and that the court determine (R. 43) whether it——

> " * * * should enjoin and restrain the holders of the said collateral notes, *in the event of default in the payment of interest thereon,* or other default therein, from selling and converting the said collateral, or any part thereof; * * * " (Italics ours).

Having, as above stated, received notice by mail of said petition, petitioners appeared specially (R. 68-75). In support of their respective special appearances, the non-resident banks filed affidavits which disclosed that they were not residents of or present within the Northern District of Illinois, were not parties to the proceeding, and had never been served with process (R. 116-119).

A Committee for holders of the Debtor's First and Refunding Mortgage Bonds appeared and filed the affidavit of its Chairman, Dwight S. Beebe (R. 113-115), which alleged, *inter alia*, that approximately $145,749,050 face amount of bonds and stock of the "Debtor's System" were pledged with Trustees under three of the Debtor's mortgages; "that in certain events described in the Indentures under which the aforesaid Trustees are acting, such Trustees are given the right to sell such collateral"; that a decision that the R. F. C. and the banks should not be enjoined from selling the collateral held by them "would also determine that the Trustees under the three bond issues mentioned above had the right to sell the $145,749,050 total face amount of capital obligations of the System pledged with them"; and that the "*position of this Committee* • • • is that the interests of the bondholders • • • and of the Debtor's estate generally would best be served • • • by a decision requiring all holders of secured claims to retain their collateral until a plan of reorganization is prepared, approved and put into effect."

A Committee for holders of the Debtor's General Mortgage Bonds appeared and filed an answer objecting to the payment of interest on any collateral loans of the Debtor (R. 59-63).

On the same day (September 26, 1933), the court authorized the Debtor to pay interest due R.F.C. on September 30, 1933, but reserved decision on the matter of an injunction, the petitioners and R.F.C. agreeing in open court—upon the judge's statement that otherwise he was prepared to issue an injunction immediately—that *until the judge could reach a decision* they would not sell any of the collateral without five days' notice to the Debtor (R. 75-77).

Thereafter, on November 22, 1933, the court entered an order restraining these petitioners and R.F.C. from selling or converting the collateral held by them, or any part thereof, until further order of the court (R. 101-104). This order was entered by the trial judge without any opinion, written or oral, and *solely upon said petition of the Debtor*, the *Beebé affidavit, the General Mortgage Committee answer* (which did not concern itself with the injunction issue), *the special appearances, and the affidavits filed by the non-resident banks* (which latter merely questioned the court's jurisdiction over the persons of said banks).[3] From the recitals in the order, it appears (R. 103-104) that the trial judge held—

(1) That the injunction was necessary in order to permit the consummation of a plan of reorganization,

(2) That the court had power to issue any order which might be necessary for the enforcement of Section 77.

Upon the appeals, the Circuit Court of Appeals held—

(1) That the injunction was an exercise of authority which was *incident* to powers expressly conferred upon the District Court by Section 77 (R. 324).

(2) That the injunction merely restrained the "immediate pursuit of a remedy" and therefore (a) could be issued in a summary proceeding, and (b) did not violate the Fifth Amendment (R. 324).

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[3] At the hearing before the District Judge (at which three Protective Committees other than those above mentioned appeared and submitted briefs; see R. 314-315), it was orally stipulated by counsel for respondents that none of petitioners should be deemed to have waived its respective special appearance "by presenting oral argument or in filing briefs in opposition to the said application for an injunction" (R. 119). At no time did the parties stipulate, as asserted in the brief in opposition (p. 4), that the petitioners "might contest the merits of the application without waiving their special appearances."

(3) That the jurisdiction of a bankruptcy court under Section 77 is, in effect, "co-extensive with the territorial boundaries of the United States," and hence the injunction was lawful even though the non-resident banks, and the collateral held by them, were not within the Northern District of Illinois (R. 322).

Three serious misapprehensions of fact, which seem to have influenced the Circuit Court of Appeals strongly, should be noted:

(1) The court stated (R. 325) that—

> "Appellants have received and will probably continue to receive the prompt payment of interest upon their claims secured by the debtor's and its subsidiaries' bonds."

This statement is erroneous. Although interest was paid, as due, upon the notes held by petitioners and R. F. C. until the injunction (R. 17, 22, 36, 75), *no interest whatever, due thereafter, has been paid* (R. 341-342). The notes held by petitioners and R. F. C. matured on March 1, 1934 (R. 37-38), are now unpaid, and there is now due to petitioners approximately $310,000 in interest thereon.

(2) The court also stated (R. 324) that—

> "The controversy was restricted to a restraining of the *immediate* pursuit of a remedy by the creditors in order that a plan might be presented ***which would take care of appellants' claims in full*** but without special ind irreparable injury to the other creditors, * * *" (Italics ours).

As to this statement, no plan of reorganization was then before the District Court, none has since been presented, and recently the Debtor's Trustees have advised the Interstate Commerce Commission (see Appendix to R. F. C. brief, pp. 167-173) that there is no likelihood of any plan *even being formulated in the near future.* Moreover, if some time such a plan is presented and thereafter consummated, there was nothing before the court which warranted the statement that such plan would *"take care of appellants' claims in full."*

(3) The court also stated (R. 325) that the District Court—

> "sought to protect the great mass of debtor's creditors *without injuring the position of appellants* * * *." (Italics ours.)

The fact is that when the petition for an injunction was filed, the collateral held by petitioners possessed a market value (based on last prior sales on the New York Stock Exchange) of $4,153,355, *i. e.,* substantially in excess of the amount of the indebtedness then due from the Debtor. At the writing of this brief (January 12, 1935), the market value of said collateral (on the same basis) is $2,389,980. These figures indicate that already the injunction has damaged petitioners in excess of $1,700,000.

Specification of Errors.

The Circuit Court of Appeals erred—

(1) In holding that, in a proceeding under Section 77 of the Bankruptcy Act, a district court may in a summary proceeding enjoin a non-judicial sale of collateral which has been validly pledged by the debtor to

and is held by a pledgee as security for a note of the debtor, when such collateral consists of secured bonds (a) of the debtor and (b) of a subsidiary corporation of an aggregate par value substantially in excess of the amount of the note.

(2) In holding that a sale of the collateral held by petitioners would in effect prevent the orderly preparation and consummation of a plan of reorganization of the debtor.

(3) In holding that an injunction against the sale of the pledged collateral was necessary for the enforcement of the provisions of Section 77.

(4) In holding that Section 77, as construed by the courts below, did not violate the Fifth Amendment.

(5) In holding that, in a proceeding under Section 77, a district court sitting in one district can enjoin the sale of collateral which has been validly pledged by the debtor as security for a note, although the pledgee (a) is not a party to the proceeding, (b) is not a resident of or present within such district, and (c) holds the pledged collateral beyond the limits of such district. (*Urged only by the non-resident banks.*)

(6) In failing to hold that the District Court had no jurisdiction to enter the injunctional order.

SUMMARY OF ARGUMENT.

I.

By Section 77 (n), the jurisdiction of a bankruptcy court in a proceeding under Section 77 is the same as that of the court in an ordinary bankruptcy proceeding, unless such jurisdiction is inconsistent with Section 77.

A bankruptcy court is without jurisdiction in an ordinary bankruptcy proceeding to restrain a pledgee from exercising his contract right to sell collateral validly pledged to him by the bankrupt, even though the pledged collateral consists of secured obligations of the bankrupt. This want of jurisdiction exists because (a) the Bankruptcy Act expressly preserves the rights of the pledgee, and (b) a bankruptcy court has no jurisdiction (save in specified cases not here material) to deal with property not in the actual or constructive possession of the bankrupt.

Section 77 does not confer upon a bankruptcy court proceeding under that section jurisdiction to issue such a restraining order, since there is nothing in that section which negatives either of the two bases of the rule that a bankruptcy court is without authority to issue such a restraining order in an ordinary bankruptcy proceeding. In fact, various provisions of Section 77, as well as its legislative history, show clearly that Congress intended that the court should not possess authority to issue such a restraining order.

Section 2 (15) of the Bankruptcy Act, which provides generally that the court may issue such orders as may be necessary for enforcing the Act, is in no sense a source of jurisdiction, and confers no greater powers in the matter of enjoining sales of pledged collateral upon a court proceeding under Section 77 than it has in the past been construed to confer upon a bankruptcy court in an ordinary voluntary proceeding.

II.

If, as petitioners contend, the District Court was without jurisdiction to issue the injunction, a consideration of the effect, if any, of a sale of the pledged collateral upon a plan of reorganization is irrelevant. Petitioners contend, however, that there was no evidence before the District Court which sustains its

conclusion that the injunction was "necessary for the enforcement of the provisions of Section 77."

III.

As construed and applied by the courts below, Section 77 violates the Fifth Amendment by depriving petitioners of a substantial and pre-existing vested right, i. e., the right to sell the pledged collateral, upon default, at such time as they may select. Even if the injunction be held to affect merely petitioners' remedy, it was an unreasonable and arbitrary modification and postponement of such remedy, in violation of the Fifth Amendment.

IV.

The decision of the court below (which is predicated upon a theory applicable to Section 77-B of the Bankruptcy Act, as well as to Section 77) overturns a rule of bankruptcy law upon the basis of which, in part at least, literally hundreds of millions of dollars of now outstanding short-term collateral loans were made. The hazard of having short-term liquid loans converted into frozen loans for an indefinite period will inevitably tend sharply to restrict credit, contrary to one of the underlying purposes of Section 77, and at a time when Congress and the Administration are endeavoring to accomplish the opposite result.

V.

Apart from the foregoing contentions, the District Court was without jurisdiction to issue the injunction as to the non-resident banks.

The territorial limits imposed by Congress upon district courts apply to courts of bankruptcy. An injunction, operating ***in personam,*** can be predicated only on jurisdiction over the person enjoined, and the District Court had no jurisdiction over those petitioners which were not parties to the proceeding and which were neither residents of nor present within the Northern District of Illinois. The "exclusive jurisdiction" over the "debtor and its property wherever located" conferred upon the court by Section 77 (a) is the same as that possessed by a bankruptcy court in an ordinary bankruptcy proceeding. Section 77 does not extend either the territorial limits of the court or the court's jurisdiction ***in personam*** over non-residents.

ARGUMENT.

I.

Section 77 does not confer jurisdiction on the court to enjoin the sale of validly pledged collateral, even though such collateral consists of mortgage bonds of the debtor railroad.

The respondents, in effect, concede (Br. in Opp., pp. 11-15) that if this were an ordinary bankruptcy proceeding, the District Court would have been without authority to issue the injunction. But they contend, and the court below held, that in a proceeding under Section 77, a bankruptcy court has a wider jurisdiction in the matter of enjoining the sale of validly pledged collateral than is possessed by the court in an ordinary bankruptcy proceeding.

The principal pertinent provisions of Section 77 are (pp. 92-93, *infra*):

> (1) Section 77 (a), which provides that the court shall "have exclusive jurisdiction of the debtor and its property wherever located";
>
> (2) Section 77 (l), which provides that the judge may "enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate"; and
>
> (3) Section 77 (n), which provides that, consistent with the provisions thereof, the "jurisdiction and powers of the court" shall be "the same as if a voluntary petition for adjudication had been entered on the day when the debtor's petition was filed."

Since, under Section 77 (n), the "jurisdiction and powers of the court" are expressly "the same" as in a

voluntary bankruptcy proceeding, unless changed by Section 77 or inconsistent therewith, it is impossible to determine the jurisdiction of the court in a proceeding under Section 77, or to construe the provisions above quoted, with out a consideration of the jurisdiction of a bankruptcy court in an ordinary bankruptcy proceeding.

A. A bankruptcy court in an ordinary bankruptcy proceeding is without jurisdiction to enjoin a pledgee from selling pledged collateral, pursuant to the pledge agreement, even though the collateral consists of mortgage bonds of the bankrupt.

The collateral held by petitioners consists of (a) secured bonds of the Debtor, and (b) secured bonds of a subsidiary corporation of the Debtor (R. 20, 39, 103), all of which were pledged and delivered to petitioners more than four months prior to the filing of the Debtor's petition under Section 77 (R. 2, 38-39, 48-49, 52, 320). The validity of the pledges is conceded (Br. in Opp., p. 7; R. 324), and there is no suggestion that petitioners are seeking to sell the pledged collateral in a fraudulent manner or in any way not authorized by the pledge agreements. Upon these facts, it is clear that in an ordinary bankruptcy proceeding the District Court would have been without jurisdiction to issue the injunction.

By the great weight of authority, a bankruptcy court cannot enjoin the sale of securities or other collateral validly pledged to a creditor by the bankrupt more than four months prior to bankruptcy of the pledgor. *Jerome* v. *McCarter,* 94 U. S. 734, 739 (1876); *In re Mertens,* 144 Fed. 818, 823-824 (C. C. A. 2d, 1906), aff'd *sub. nom. Hiscock* v. *Varick Bank of New York,* 206 U. S. 28 (1907); *In re Hud-*

son River Navigation Corporation, 57 F. (2d) 175 (C. C. A. 2d, 1932); *In re Ironclad Mfg. Co.*, 192 Fed. 318 (C. C. A. 2d, 1912); *In re Mayer*, 157 Fed. 836 (C. C. A. 2d, 1907); *In re Ward*, 104 Fed. 985 (D. Mass., 1900); *In re Browne*, 104 Fed. 762 (E. D. Pa., 1900); *Mercer Nat. Bank of Harrodsburg* v. *White's Ex'r*, 32 S. W. (2d) 734, 737 (Ky., 1930); *Harvey* v. *Smith*, 61 N. E. 217 (Mass., 1901); accord, *In re Chaiken*, 10 Am. Bank. Rev. 14 (M. D. Pa., 1933); *In the matter of Charles P. Doelger*, 9 Am. Bank. Rev. 329 (S. D. N. Y., 1933), construing Section 74 of the Bankruptcy Act. See also *In re Jersey Island Packing Co.*, 138 Fed. 625, 628 (C. C. A. 9th, 1905).[4]

Similarly, in equity receiverships the court is without authority to enjoin the sale of pledged collateral validly held by a pledgee of the insolvent corporation. *International Banking Corporation* v. *Lynch*, 269 Fed. 242, 245 (C. C. A. 9th, 1920); *Risk* v. *Kansas Trust & Banking Co.*, 58 Fed. 45, 46 (C. C. D. Kan., 1893); *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475 (E. D. Pa., 1921); *Northern Pacific Railway* v. *Frank Waterhouse & Co.*, 279 Fed. 750, 751-752 (W. D. Wash., 1922); see also *Guaranty Trust Co.* v. *Fentress*, 61 F. (2d) 329 (C. C. A. 7th, 1932).

In *In re Hudson River Navigation Corporation*, 57 F. (2d) 175 (C. C. A. 2d, 1932), *supra*, a trustee in bankruptcy applied to an ancillary bankruptcy court (in the district where the pledgee resided and held the pledged collateral)

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[4] These cases should be distinguished from cases like *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2d, 1911), which involved a so-called pledge of the debtor's *wholly unsecured obligations*. In the case cited the court said (p. 558) that "in the distribution of bankrupt estates, *paper obligations issued without consideration as security for an indebtedness*" ought not be "permitted to increase it," and on this basis sustained an injunction against the sale of the so-called collateral.

for an order restraining the sale of certain collateral, consisting of notes of third parties, a chattel mortgage, and shares of corporate stock, which had been pledged by the bankrupt to a bank. The trustee's petition, which was closely similar to the Debtor's petition in the instant cases (R. 40), did not assert that the pledge was invalid, but alleged that a sale of the collateral at that time would result in a great sacrifice, that some of the pledged securities were essential to the conduct of the bankrupt's business, and that a reorganization was in contemplation at which all the bankrupt's property would be sold. In denying the injunction, the court said (p. 176):

> "* * * it has been generally understood that bankruptcy does not touch the power of a pledgee of shares of stock to close out his collateral."

The rule above set forth applies without discrimination to all kinds of pledged collateral rightfully in possession of the pledgee, including *secured bonds of the bankrupt itself in a face amount in excess of the indebtedness for which they were pledged. Jerome* v. *McCarter,* 94 U. S. 734, 739 (1876), *supra; In re Ironclad Mfg. Co.,* 192 Fed. 318 (C. C. A. 2d, 1912), *supra;* see also *Turner* v. *Metropolitan Trust Co.,* 207 Fed. 495 (C. C. A. 9th, 1913). Likewise, by the great weight of authority, in an equity receivership the court cannot restrain the sale of secured bonds of the insolvent corporation which have been *validly issued* and pledged by the corporation. *Guaranty Trust Co. of N. Y.* v. *Galveston City Railway Co.,* 87 Fed. 813, 815 (C. C. A. 5th, 1898); *Rogers Brown & Co.* v. *Tindel Morris Co.,* 271 Fed. 475, 476 (E. D. Pa., 1921); *Matter of Binghamton General Electric Company,* 38 N. E. 297 (N. Y., 1894), *supra.* See also *Dibert* v. *Wernicke,* 214 Fed.

673, 680 (C. C. A. 6th, 1914); *Bush* v. *Adams*, 165 Fed. 802 (S. D. N. Y., 1908).[5]

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[5] A seemingly contrary result was reached in *Mississippi Valley Trust Co.* v. *Railway Steel Spring Co.*, 258 Fed. 346 (C. C. A. 8th, 1919). The decision in that case, however, was predicated solely upon the law of Missouri, since "the transaction was a Missouri transaction." By the law of that State, a pledge by a corporation of its own *unissued mortgage bonds does not constitute an issuance of such bonds* (*Dibert* v. *D'Arcy*, 154 S. W. 1116 (Mo., 1913)) and the court's decision was expressly founded (see pp. 351, 352-353) on the fact that under the rule of the *Dibert* case, the bonds in question had never "been 'put in circulation for value.'"

The Missouri view is opposed to that of Illinois (see *Peacock* v. *Phillips*, 93 N. E. 415, 417 (Ill., 1910); *Gilbert* v. *Fossten Mfg. Co.*, 218 N. W. 451 (Minn., 1928)) and that of New York (see *Duncomb* v. *The N. Y., H. & N. R. Co.*, 84 N. Y. 190 (1881); *In re Progressive Wall Paper Corp.*, 229 Fed. 489 (C. C. A. 2d, 1916); *In re Waterloo Organ Co.*, 134 Fed. 345 (C. C. A. 2d, 1904), cert. den. 197 U. S. 621 (1904)). Indeed, Missouri appears to stand alone in denying a pledgee any right whatsoever to sell the pledged mortgage bonds of the pledgor. (See Hatch, "A Form of Depression Finance—Corporations Pledging Their Own Bonds," 47 H. L. Rev. 1093, 1117.)

That a pledge of its own mortgage bonds by a corporate debtor constitutes a valid "issue" thereof, see, in addition to cases cited at page 19, *supra*, *Gilchrist Transp. Co.* v. *Phenix Ins. Co.*, 170 Fed. 279 (C. C. A. 6th, 1909); *Equitable Trust Co.* v. *Great Shoshone & Twin Falls Water Power Co.*, 228 Fed. 516 (D. Idaho, 1915); *Atlantic Trust Co.* v. *Woodbridge Canal & Irrigation Co.*, 79 Fed. 842 (C. C., N. D. Cal., 1897); *In re Valecia Condensed Milk Co.*, 240 Fed. 338 (C. C. A. 7th, 1917); *Worth* v. *Marshall Field & Co.*, 240 Fed. 395 (C. C. A. 4th, 1917); *William Firth Co.* v. *South Carolina Loan & Trust Co.*, 122 Fed. 569 (C. C. A. 4th, 1903); *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475 (E. D. Pa., 1921); *Heath* v. *Port of Para*, 262 Fed. 815 (S. D. N. Y., 1920); *Smith* v. *Pillsbury*, 178 Pac. 719 (Cal. App., 1919); *Nelson* v. *Hubbard*, 11 So. 428 (Ala., 1892). And see, in this connection, *In re Paul De Laney Co., Inc.*, 26 F. (2d) 961 (C. C. A. 2d, 1928), and *Memphis & Little Rock Railroad* v. *Dow*, 120 U. S. 287 (1887).

Moreover, in the *Mississippi Valley Trust Co.* case, the court relied strongly on the fact that the pledged bonds were previously unissued treasury bonds (see p. 351). It does not appear on the record that that is the situation as to the bonds of the Debtor held by petitioners.

Thus, in *Jerome* v. *McCarter*, 94 U. S. 734 (1876), *supra*, the Court, speaking with reference to a pledge by the bankrupt of its own secured bonds, said (p. 739):

> "There is some proof that, when the company became bankrupt (Aug. 28, 1872), *some of the bonds were held as collaterals for loans made to the company smaller in amount than the bonds pledged.* But the bonds were subsequently sold by the pledgees, and the present holders hold them by absolute right. *The position that the pledgees could not sell the pledge after the adjudication in bankruptcy, is quite untenable.* It is sustained by nothing in the Bankrupt Act. The bonds were negotiable instruments. They passed by delivery, and even were there no expressed stipulation in the contracts of pledge, that the pledgee might sell on default of the pledgor, such a right is presumable from the nature of the transaction. *Certainly the Bankrupt Act has taken away no right from a pledgee secured to him by his contract.* [Note: Italics used hereinafter are always ours unless otherwise indicated.]

The rule that *a bankruptcy court* cannot enjoin the sale by a pledgee of validly pledged collateral in his possession rests upon two bases, either of which alone sustains the rule: (1) By the Bankruptcy Act itself the rights of the pledgee are preserved, and hence bankruptcy of the pledgor does not affect the lien or remedies of the pledgee (a factor which would inhibit an injunction *in any forum*), and (2) A bankruptcy court cannot, except in specified instances not here pertinent, adjudicate controversies with respect to property not in its possession.

1. The bankruptcy of the pledgor does not affect the lien of the pledgee or his right upon default to realize upon the pledged collateral.

By Section 67 (d) of the Bankruptcy Act (p. 91, *infra*):

> "Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act and for a present consideration * * * shall, to the extent of such consideration only not be affected by anything herein."

And by Section 57 (h) (p. 91, *infra*):

> "The value of *securities* held by secured creditors shall be determined by converting the same into money *according to the terms of the agreement* pursuant to which such securities were delivered to such creditors or * * *."

Construing these provisions, the courts have uniformly held that bankruptcy of the pledgor does not deprive the pledgee of any rights secured to him by the pledge agreement or by the law of the state where the pledge was made. *Hiscock* v. *Varick Bank of New York*, 206 U. S. 28, 40 (1907); *Yeatman* v. *Savings Institution*, 95 U. S. 764 (1877); *Jerome* v. *McCarter*, 94 U. S. 734, 739 (1876), *supra; Taney* v. *Penn Bank*, 232 U. S. 174 (1914); *In re Hudson River Navigation Corporation*, 57 F. (2d) 175, 176 (C. C. A. 2d, 1932), *supra; In re Peacock*, 178 Fed. 851, 858 (E. D. No. Car., 1910); *In re Browne*, 104 Fed. 762 (E. D. Pa., 1900), *supra;* see also *In re Chaiken*, 10 Am. Bank. Rev. 14 (M. D. Pa., 1933), *supra*, construing Section 74 of the Bankruptcy Act. Cf. *York Manufacturing Co.* v. *Cassell*, 201 U. S. 344, 352 (1906).

Thus, in *Hiscock* v. *Varick Bank of New York, supra*, this Court said (p. 41):

"When the petition in the present case was filed the bank had a valid lien upon these policies for the payment of its debt. The contracts under which they were pledged were valid and enforceable under the laws of New York where the debt was incurred and the lien created. *The bankruptcy act did not attempt by any of its provisions to deprive a lienor of any remedy which the law of the State vested him with;* * * *."

In the *Hiscock* case the Court not only held that bankruptcy of the pledgor in no way affects the pledgee's lien, but that it does not affect his "remedy."[6]

The validity of petitioners' liens being conceded (Br. in Opp., p. 7; R. 324), it follows that the District Court was without authority to issue the injunction—unless that court

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[6] Cases like *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734 (1931), and *Allebach* v. *Thomas*, 16 F. (2d) 853 (C. C. A. 4th, 1927)—the latter of which was relied upon by respondents in the courts below—are not contrary to this conclusion, since they involve the restraint of enforcement of a lien (a) *by judicial proceedings*, (b) upon mortgaged real estate, *i. e., property in possession of the bankruptcy court, and property not falling within the provisions of Section 57 (h) of the Act.* Where a bankruptcy, or any other, court takes possession of property, such property is withdrawn from the jurisdiction of all other courts. The lien of the mortgagee is not lost since presumably the mortgaged property can and will be sold quite as satisfactorily by one court as by another (see pp. 73-74, *infra*). Moreover, when the bankruptcy court does not have possession of the mortgaged premises, *i. e.*, when the creditor has instituted proceedings to foreclose the lien more than four months prior to bankruptcy of the mortgagor, the bankruptcy court is without power to enjoin the foreclosure proceedings. *Straton* v. *New*, 283 U. S. 318 (1931). Cf. *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475, 476 (E. D. Pa., 1921), *supra*.

If the statement in *Allebach* v. *Thomas*, *supra*, at page 855, that a bankruptcy court may interfere with the lienor's "'remedy" (so long as it affords him "an equally adequate remedy") is held applicable to pledged *securities*, it is in conflict with the *Hiscock* case. And see *In re Hudson River Navigation Corporation*, 57 F. (2d) 175, 176 (C. C. A. 2d, 1932), *supra*.

possessed a greater power in the premises in a proceeding under Section 77 than it possesses in the ordinary bankruptcy proceeding, a point later discussed (pp. 34-48, *infra*).

2. A bankruptcy court cannot in any form of proceeding adjudicate controversies with respect to property not in its possession (except in specified cases not here pertinent). Collateral validly held by a pledgee is not actually or constructively in possession of the bankruptcy court.

A court of bankruptcy is one of sharply limited jurisdiction. By Section 2 of the Bankruptcy Act (p. 91, *infra*), "courts of bankruptcy" are merely invested "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction *in bankruptcy proceedings*," whereas by Section 23 (U. S. C. A., Title 11, Sec. 46) the *district courts* are given jurisdiction of all controversies, as distinguished from proceedings, in bankruptcy, to the same extent as though the action had been brought by the bankrupt himself.

Although the trustee, upon adjudication of bankruptcy, acquires title to all property of the bankrupt, wherever located, the only property which passes into the control and jurisdiction of the bankruptcy court is that in the actual or constructive possession of the bankrupt when the petition is filed. See *Schumacher* v. *Beeler*, No. 215, Present Term, page 3, footnote 2; *Straton* v. *New*, 283 U. S. 318, 321 (1931); *Acme Harvester Co.* v. *Beekman Lumber Co.*, 222 U. S. 300, 308 (1911); *Mueller* v. *Nugent*, 184 U. S. 1, 14 (1902); *In re Lake County Fuel & Supply Co.*, 70 F. (2d) 391, 392 (C. C. A. 7th, 1934), cert. den., No. 179, Present Term; *Lynch* v. *Roberson*, 287 Fed. 433 (C. C. A. 6th, 1923); *In re Smith*, 3 F. (2d) 40 (S. D. Tex., 1924), aff'd

sub. nom. Paynter v. *Slator,* 8 F. (2d) 1021 (C. C. A. 5th, 1925).

Thus, in *Isaacs* v. *Hobbs Tie & Timber Co.,* 282 U. S. 734 (1931), the Court said (p. 737):

> "The title and right to possession of all property owned *and possessed* by the bankrupt vests in the trustee as of the date of the filing of the petition in bankruptcy, * * *."

More recently, and *in a case involving Section 77,* the Court said in *Ex parte Baldwin,* 291 U. S. 610, 615 (1934):

> "All property *in the possession of a bankrupt* of which he claims the ownership passes, upon the filing of a petition in bankruptcy, *into the custody of the court of bankruptcy.*"

The cases above cited establish that the bankruptcy court's lack of jurisdiction over property not in its possession exists irrespective of whether the proceeding *is summary or plenary.* It is only with respect to property in its custody that the court possesses *any jurisdiction,* either summary or plenary, to adjudicate controveries without consent,—except that it possesses *plenary jurisdiction* to adjudicate controversies with respect to property not in its possession in the specific cases covered by Section 60 (b), 67 (e) and 70 (e) of the Act.[7] *Taubel-Scott-Kitzmiller Co., Inc.,* v. *Fox,* 264 U. S. 426 (1924): cf. *Bardes* v. *Hawarden Bank,* 178 U. S. 524 (1900).

Thus, in *Taubel-Scott-Kitzmiller Co., Inc.,* v. *Fox, supra,* the Court said (p. 434):

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[7] These sections (see Appendix to R. F. C. brief, pp. 85-88) have no application to a valid pledge of collaterals delivered to the pledgee more than four months prior to bankruptcy of the pledgor.

> "• • • In the absence of possession, there was under the Bankruptcy Act of 1898, as originally passed, no jurisdiction, without consent, to adjudicate the controversy *even by a plenary suit.* The Act of February 5, 1903, • • • together with the Act of June 25, 1910, • • • conferred upon the bankruptcy court jurisdiction, under certain circumstances, *against the adverse claimant, in a plenary suit* under §60, subdivision b, §67, subdivision e, and §70, subdivision e."

The foregoing thus establishes a further reason why a bankruptcy court cannot enjoin the sale of collateral validly held by a pledgee of the bankrupt, *i. e.*, lack of possession of and dominion over the property the use of which is sought to be restrained. This lack of dominion, and consequent lack of jurisdiction—notwithstanding jurisdiction over the person of the pledgee—is clearly set forth in *In re Hudson River Navigation Corporation*, 57 F. (2d) 175 (C. C. A. 2d, 1932), *supra*, where the court said (pp. 175-176):

> "For practical purposes the pledgee has therefore immediate dominion as between the two, and with it goes the power to resist any action by the bankruptcy court, *which must be founded on the fact that the bankrupt had such dominion, when the petition was filed.* • • •
>
> "• • • *when the bankrupt has surrendered dominion*, the immunity extends not only to the right, but to the forum as well. The bankruptcy court had no jurisdiction to stay the proposed sale. • • •"

Similarly, it was said by the court below itself, in *In re Parmenter*, 70 F. (2d) 929, 935 (C. C. A. 7th, 1934), cert. den. No. 236, Present Term:

> "• • • it has always been held that a bankruptcy court *has no jurisdiction whatever* over pledged secu-

> rity which has been transferred in good faith by a debtor to his creditor more than four months prior to the filing of the bankruptcy petition."[8]

It being apparent, in the instant cases, that the Debtor had neither actual nor constructive possession of the *collateral held by petitioners*, the court below held, in effect, that the District Court had jurisdiction over the Debtor's "equity" in that collateral, *i. e.*, the Debtor's right to discharge the indebtedness and reacquire the collateral, or to receive any surplus of the proceeds of the collateral remaining after payment of the debt (R. 322-323).

As to the Debtor's *own bonds* (as distinguished from the Short Line bonds) held by petitioners, it may be doubted whether the Debtor possessed *any equity therein*, since such bonds are, as to the debtor, not property, but

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[8] In this connection, it should be noted that although the appointment of a receiver by a federal court confers upon that court jurisdiction to decide all questions "incident to the preservation, collection and distribution of the assets" of the debtor (*Riehle, Receiver* v. *Margolies*, 279 U. S. 218 (1929)), such court may not restrain a pledgee from enforcing his lien by sale of the pledged collateral. (See pp. 18-19, *supra*). Thus, in *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475 (E. D. Pa., 1921), *supra*, the court said (p. 476):

> "The argument that, because the mortgaged premises are in the hands of the court, the bonds cannot be sold, does not meet the point. The principle is wholly different. No court would permit its possession and control of property under its care to be disturbed; but, although the court has possession of the mortgaged premises, it has not of the bonds. *The control pivots on the possession.*"

In re White Truck & Transfer Co. (S. D. Cal.), decided Sept. 4, 1934, cited by respondents (Br. in Opp., p. 4), and involving Section 77 B, is not inconsistent with this result, since there the injunction was issued against a chattel mortgagee and a conditional sales vendor who *were not in possession of the property in question.*

merely obligations or evidences of debt. (See *Easton* v. *German-American Bank*, 127 U. S. 532, 539 (1888); *Guaranty Trust Co. of N. Y.* v. *Galveston City Railway Co.*, 87 Fed. 813, 815 (C. C. A. 5th, 1898).)

In any event, the Debtor's so-called "equity" is not the "property" with which a pledgee deals when he sells collaterals which he holds as pledgee, and the court below clearly erred when it held that the District Court had jurisdiction over property *in possession of petitioners* because the Debtor at the time it filed its petition under Section 77 had an "equity" in such collaterals.

It is settled that a bankruptcy court has jurisdiction over *mortgaged* property of the bankrupt, including that mortgaged more than four months prior to the filing of the petition in bankruptcy. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734 (1931). But decisions so holding are not based on the fact that the mortgagor retains an "equity" which passes to the bankruptcy court, but upon the ground that the mortgaged property itself was in the actual possession of the bankrupt at the time of the filing of the petition. See *In re Jersey Island Packing Co.*, 138 Fed. 625, 628 (C. C. A. 9th, 1905).

Since it is the pledged property which the pledgee seeks to sell, the bankruptcy court must acquire possession of *that property* before it may deal with the same. The fact that the bankrupt's trustee has the right to acquire possession of the pledged collateral upon payment of the indebtedness does not vest the court with any greater jurisdiction over such pledged collateral than is possessed by an equity court in a like situation, nor give the court possession thereof prior to the payment of the debt.

The most persuasive argument against the theory of the court below is the fact that, notwithstanding a bankruptcy court has jurisdiction over the bankrupt's property "wherever situated" (cases, pp. 40, 84-85, *infra*), such courts have almost uniformly refused to enjoin a pledgee from selling validly pledged collateral in his possession, notwithstanding that in all such cases the same so-called "equity" of the bankrupt existed. In none of such cases was it held that such equity was "property of the bankrupt" within the control of the bankruptcy court, or that the bankruptcy court acquired jurisdiction over the pledgee and the pledged collaterals simply by asserting jurisdiction over the pledgor's so-called "equity." Cf. *Guaranty Trust Co.* v. *Fortress*, 61 F. (2d) 329 (C. C. A. 7th, 1932).

3. The decisions holding that a bankruptcy court cannot enjoin the sale of validly pledged collateral are further supported by the rule that a bankruptcy court is without jurisdiction to adjudicate in a summary proceeding a controversy with respect to property held by an adverse claimant.

As shown above, the lack of power in a bankruptcy court to enjoin the sale of pledged collateral is a disability which goes not merely to the *form* of the proceeding but to the *forum* itself. The fact, however, that the injunction in the instant cases was entered *in a summary proceeding* affords an opportunity for demonstrating the error of the courts below by a long line of cases which do not deal specifically with the matter of restraints upon the sale of pledged collateral.

If, when a bankruptcy petition is filed, certain property is in the possession of a third party and such party asserts

a substantial, pre-existing claim of title or lien with respect thereto, any right of the bankruptcy court to assert jurisdiction over that property is dependent upon a reduction of it to the possession, actual or constructive, of the bankruptcy court. This cannot be done in a summary proceeding in the bankruptcy court, but requires a plenary proceeding outside the bankruptcy court (except in the specific cases falling under Sections 60 (b), 67 (e) and 70 (e)). The party thus in actual possession is an "adverse claimant," and he is *of right* entitled to have his rights in reference to that property litigated in a court in which he might have been sued by the bankrupt had bankruptcy not intervened. (See Section 23 of the Bankruptcy Act, as amended; U. S. C. A., Title 11, Sec. 46.)

That a bankruptcy court has no summary jurisdiction with respect to rights asserted by "adverse claimants" is firmly established. Thus, in *Harrison* v. *Chamberlin*, 271 U. S. 191 (1926), the Court said (p. 193):

> "It is well settled that a court of bankruptcy is without jurisdiction to adjudicate in a summary proceeding a controversy *in reference to property held adversely to the bankrupt estate*, without the consent of the adverse claimant; but resort must be had by the trustee to a plenary suit."

See also *Taubel-Scott-Kitzmiller Co., Inc.*, v. *Fox*, 264 U. S. 426, 432-433 (1924), *supra; Weidhorn* v. *Levy*, 253 U. S. 268, 272 (1920); *May* v. *Henderson*, 268 U. S. 111, 115 (1925); *Louisville & Nashville R. Co.* v. *Eubank*, 184 U. S. 27 (1902); *Gilbert's Collier on Bankruptcy* (3d ed., 1934), §697; V *Remington on Bankruptcy* (3d ed., 1923), §2350.

In order to be an "adverse claimant" it is not necessary to assert a claim of absolute title to the property. *Jaquith*

v. *Rowley*, 188 U. S. 620, 624 (1903). Lien holders and secured creditors, including pledgees, have frequently been held to be "adverse claimants." *First National Bank of Chicago* v. *Chicago Title & Trust Company*, 198 U. S. 280 (1905); *Morton G. Thalhimer, Inc.*, v. *Florance*, 58 F. (2d) 23 (C. C. A. 4th, 1932); *American Trust & Savings Bank* v. *Ruppe*, 237 Fed. 581, 584 (C. C. A. 8th, 1916); *Fitch* v. *Richardson*, 147 Fed. 197 (C. C. A. 1st, 1906); *In re Rathman*, 183 Fed. 913, 921 (C. C. A. 8th, 1910); *Ft. Dearborn Trust & Savings Bank* v. *Smalley*, 298 Fed. 45, 50 (C. C. A. 8th, 1924).

In *In re Bacon*, 210 Fed. 129 (C. C. A. 2d, 1913), the court, speaking with respect to a bank asserting a concededly valid lien upon certain stocks held as security for debts due it from the bankrupt, said (p. 131):

> "It is enough to know that the First National Bank claims that under the law of New York it has a lien on these stocks as a security for debts due from Bacon to it. The trustee's petition was framed upon the theory that the bank had valid claims secured by these stocks. The bank has been throughout *asserting an adverse claim* and that its right in the stocks has been established by the New York courts."

The court below held that petitioners did not occupy such an "adversary status" as to require a plenary suit, since the "trustees admit the legality of the security held by the creditors," and the controversy "was restricted to a restraining of the *immediate pursuit* of a *remedy*" (R. 324). In so holding, the court misconceived the rule of law above set forth.

In the first place, the court erred when it stated that the controversy was "restricted to a restraining of the

immediate pursuit of a remedy." This statement necessarily implies either (a) that in lieu of a remedy of which petitioners are deprived they are to be given another which *in substance is the equivalent of the former,* or (b) that petitioners' remedy is being withheld from them only for a brief period after which they may be allowed to exercise it. Neither of such implications is warranted.

The fact is, neither court below has stated *just what petitioners are to be given in lieu of their express contract right to sell the collateral when they choose to do so,* and it is doubtful if either court or the respondents had or have any clear idea (certainly petitioners do not) as to just what petitioners are ultimately to be allowed to do with the collateral. It is quite clear that whatever "remedy" petitioners are ultimately to get is not to be made available to them until the consummation of a plan of reorganization (see R. 104), but whether such "remedy" will be a sale of the collateral (by petitioners or by the court) or will be the right to accept new securities in lieu of the pledged securities, is a matter of speculation. Even if ultimately petitioners are allowed to sell the pledged collateral, the fact that several years may elapse before a plan is consummated (nearly two years have elapsed without a plan even being formulated; see pp. 70-71, *infra*), at which time the value of the collateral may largely have disappeared (see p. 12, *supra*), shows that petitioners are not being given a remedy which is substantially the equivalent of their contract rights—the very essence of which is the right to select the time of sale (see *In re Hudson River Navigation Corporation, supra*)—and refutes the statement that the controversy was restricted to restraining "the *immediate* pursuit of a remedy."

But the court erred apart from the erroneous factual basis on which it acted.

Being without jurisdiction in a summary proceeding to require petitioners, adverse claimants, to surrender possession of the collateral (cases, pp. 30-31, *supra*), the court was equally without jurisdiction to issue an injunction restraining them from dealing with that collateral as pledgees thereof.

In *In re Ward*, 104 Fed. 985 (D. Mass., 1900), a creditor sought to obtain an order enjoining a third party, alleged to hold funds of the bankrupt under a contract, from making any transfer of such funds and credits. In refusing to issue such order, the court said (p. 986):

> "• • • if there is no jurisdiction to take the property, I cannot find jurisdiction to forbid its use. To take property out of a man's possession, and *to restrain him from dealing with it as owner, appear to me but different acts of exercise of the same jurisdiction.*"

In the courts below respondents cited two District Court cases which seem to hold that a bankruptcy court may, even in a summary proceeding, enjoin the sale of pledged collateral. *In re Purkett, Douglas & Co.*, 50 F. (2d) 435 (S. D. Cal., 1931), and *In re Henry*, 50 F. (2d) 453 (E. D. Pa., 1931).

The decision in the *Henry* case is opposed to the overwhelming weight of authority and, we submit, is erroneous.[9]

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[9] In the *Henry* case the court purported to follow *Isaacs* v. *Hobbs Tie & Timber Co., supra*, but made no reference to *Straton* v. *New, supra*. The court stated that it saw no distinction between pledges of "stocks" and "pledges of land," and gave no weight to the fact that in one case possession and control of the security is in the creditor, while in the other it remains with the debtor (see footnote 6, p. 23, *supra*).

The *Purkett* case, if contrary to the general rule, may be explained on the ground that the petition for the injunction alleged that the pledge was invalid, and by issuing the injunction the court undertook merely to restrain the sale by the pledgee "until the adverse claims of the respective parties can be adjudicated in a plenary suit before the appropriate forum." No such situation exists in the instant cases. Cf. *In re McGinley*, 219 Fed. 159 (C. C. A. 6th, 1915).

It is therefore clear, we submit, that the injunction could not have been issued in an ordinary bankruptcy proceeding.

B. Section 77 does not confer upon a bankruptcy court in a proceeding under that section a wider jurisdiction in the matter of enjoining a non-judicial sale of collateral pledged by the debtor than is possessed by the court in an ordinary bankruptcy proceeding.

Since the District Court would have been without authority in an ordinary bankruptcy proceeding to issue an injunction against petitioners, it follows that, in issuing the injunction now in question, that court exceeded its powers, unless—contrary to our contentions—its jurisdiction in the premises in a proceeding under Section 77 is greater than that possessed by a court of bankruptcy generally.

Chapter VIII of the Bankruptcy Act, consisting, as originally enacted, of Sections 73 to 77, inclusive (Act of March 3, 1933, 47 Stat. 1467, U. S. C. A., Title 11, Secs. 201-205), was enacted as one act pursuant to a general policy of Congress. (S. Rept. No. 1215, 72d Cong., 2d Sess.; H.

Rept. No. 1897, 72d Cong., 2d Sess.) Section 73 provides that:

> "In addition to the jurisdiction exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors, as provided in sections 74, 75 and 77 of this Act."

Section 77 was thus enacted as an addition to the Bankruptcy Act as it existed on March 3, 1933, and its obvious, as well as express, purpose was to bring railroads "under the bankruptcy jurisdiction of the Federal court." (H. Rept. No. 1897, 72d Cong., 2d Sess., p. 16.)

The principal underlying factors inducing Congress to take this action were stated by the House Judiciary Committee as follows (*ibid*, p. 5):

> "The necessity for the enactment of this section grows out of the present expensive, protracted, confusing, and inefficient administration of affairs of railroad companies engaged in interstate commerce in equity receiverships. The necessity for its immediate enactment results from the fact that at the present time many of the railroad organizations of the country confront the necessity of reorganization. • • • They must either reorganize under some arrangement such as is provided for by this section, or be administered in equity receiverships. The protracted period of such administration, the duplication of expense incident to ancillary receiverships, the waste, the opportunity for manipulation on the part of special groups, are too well known to require comment."

While Section 77 contemplates the *reorganization* of the debtor railroad, as opposed to its *liquidation*, it is an inte-

gral part of the Bankruptcy Act. Moreover, it does not appear that there is anything in the underlying purposes of that section which requires or justifies a restraint upon the sale of collateral pledged by a debtor railroad seeking the benefits of that section.

1. Except as otherwise provided in Section 77, the jurisdiction of a court in a proceeding under that section is the same as that of the court in an ordinary voluntary bankruptcy proceeding.

Section 77(n) provides (p. 93, *infra*) that:

> "In proceedings under this section and consistent with the provisions thereof, *the jurisdiction and powers of the court*, the duties of the debtor and the rights and liabilities of creditors * * * *shall be the same* as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Thus, unless altered by Section 77, or inconsistent with the provisions thereof, the jurisdiction of the court is precisely the same as that of a bankruptcy court generally.

Section 77 contains no provision which expressly or by necessary implication gives the court a wider jurisdiction in the matter of enjoining a non-judicial sale of pledged collateral than is possessed by a bankruptcy court in an ordinary bankruptcy proceeding.

In the courts below the respondents emphasized the words "consistent with the provisions thereof" in Section 77 (n) as indicating a legislative intent that the court should have all the powers of the ordinary bankruptcy court and, in addition, any *other* powers necessary or expedient for effectuating the new purposes of Section 77. But,

plainly, the words in question are a *limitation* upon the powers conferred upon the court in a proceeding under Section 77, and not a grant of additional powers. Moreover, a restraint on the sale of pledged collateral such as that applied in the instant cases is *not* "consistent with the provisions" of Section 77.

2. The specific grant of authority, by Section 77 (l), to enjoin the commencement or continuance of any judicial proceeding to enforce any lien upon the debtor's estate, negatives a grant of power to enjoin the enforcement of a lien by other than judicial proceedings.

The only provision in Section 77 dealing with restraints on the enforcement of liens is Section 77 (l), which provides (p. 92, *infra*), that:

> "In addition to the provisions of Section 11 of this Act for the staying of pending suits against the debtor, such suits shall be further stayed until after final decree [and][10] the judge may, upon notice and for cause shown, enjoin or stay the commencement or continuance of *any judicial proceeding to enforce any lien upon the estate until after final decree.*"

In the courts below certain of the respondents pointed to this provision as indicating a legislative intent that the enforcement of all liens, by any and all methods, should be held up until the consummation of a reorganization.

We question whether Section 77 (l) would apply even to a judicial proceeding to realize upon pledged collateral in the possession of the pledgee since, as above pointed out,

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[10] The word "and" seems inadvertently to have been omitted.

the only "estate" of the bankrupt over which the bankruptcy court acquires jurisdiction is that in the actual or constructive possession of the bankrupt. Moreover, it would seem that a pledgee in possession of negotiable securities has a greater interest therein than a mere "lien." See *In re Hudson River Navigation Corporation*, 57 F. (2d) 175 (C. C. A. 2d, 1932), *supra*.

But, in any event, so far as Section 77 (l) has any application to the instant cases, it clearly negatives the existence of authority to issue the injunction.

Under familiar principles of statutory construction, the express grant of this new but limited jurisdiction with respect to enjoining the enforcement of any "lien" upon the debtor's "estate" clearly negatives an intent to confer a broader or additional power of the same general character. "* * * the affirmative description of the cases in which the jurisdiction may be exercised implies a negative on the exercise of such power in other cases." *In re Heath, Petitioner*, 144 U. S. 92, 93 (1892); *Sturges* v. *The Collector*, 12 Wall. 19, 27 (1870); *Durousseau* v. *United States*, 6 Cranch 307, 314 (1810).

The application of this rule to the instant cases is unusually clear. Prior to the enactment of Section 77 the courts had almost universally held that a bankruptcy court has no power (1) to enjoin a pledgee, rightfully in possession, from exercising his power of sale (see pp. 17-19, *supra*), or (2) to interfere with a judicial proceeding to enforce a lien instituted more than four months prior to the date of the filing of the bankruptcy petition. (See *Straton* v. *New*, 283 U. S. 318 (1931).) When, therefore, by Section 77 (l), Congress expressly conferred upon a bankruptcy court the right to enjoin the *continuance* of judicial proceedings commenced *before the filing of a peti-*

tion under Section 77 (a right which it *still* does not have in the ordinary bankruptcy proceeding), it plainly denied to the court the power to enjoin a pledgee in possession of validly pledged collateral from making a non-judicial sale thereof.

This contention is sustained by two decisions construing the closely similar provisions of Section 74 (n) of the Bankruptcy Act, enacted at the same time as Section 77 (l). *In the Matter of Charles P. Doelger, Debtor,* 9 Am. Bank. Rev. 329 (S. D. N. Y., 1933); *In re Chaiken, Debtor,* 10 Am. Bank. Rev. 14 (M. D. Pa., 1933). These decisions hold squarely that in a proceeding under Section 74 the court is without authority to enjoin the sale of pledged collateral, and are based largely upon the ground that Section 74 (n)—which is similar to Section 77 (l) (see p. 93, *infra*)—was intended to apply *only to judicial proceedings.* Thus, in the *Doelger* case, *supra,* Judge Bondy said:

> "* * * it seems clear that the court's power to enjoin is restricted to court proceeding; * * *."

3. Section 77 (a) does not confer a greater jurisdiction in the matter of enjoining the sale of pledged collateral than is possessed by the court in an ordinary bankruptcy proceeding.

In affirming the injunctional order, the court below relied chiefly upon Section 77 (a) which provides (p. 92, *infra*) in part that:

> "If the petition is so approved, the court * * * shall, * * * have *exclusive jurisdiction of the debtor and his property wherever located.*"

In ascribing to the words italicized a legislative intent to grant to the court some special and enlarged powers—

not possessed by a bankruptcy court generally—over property not in the actual or constructive possession of the debtor when the petition under Section 77 is filed, the court below plainly erred.

Repeatedly this Court has defined the jurisdiction of a bankruptcy court in language almost identical with that of Section 77 (a). *Mueller* v. *Nugent*, 184 U. S. 1, 14 (1902); *Acme Harvester Co.* v. *Beekman Lumber Co.*, 222 U. S. 300, 306-308 (1911); *Lazarus* v. *Prentice*, 234 U. S. 263, 266 (1914); *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 737 (1931); *Straton* v. *New*, 283 U. S. 318, 320-321 (1931); *Ex Parte Baldwin*, 291 U. S. 610, 615 (1934). And see *Staunton* v. *Wooden*, 179 Fed. 61, 63 (C. C. A. 9th, 1910).

Thus, in *Gross* v. *Irving Trust Co.*, 289 U. S. 342 (1933), the Court said (p. 344):

> "• • • title to all the property of the bankrupt, *wherever situated*, vests in the trustee • • •. The bankruptcy court has *exclusive jurisdiction* • • •."

Similarly, in *Acme Harvester Co.* v. *Beekman Lumber Co.*, 222 U. S. 300 (1911), the Court said (p. 307):

> "The *exclusive jurisdiction* of the bankruptcy court is so far *in rem* that the estate is regarded as *in custodia legis* from the filing of the petition.

Closely similar statements appear in all the above cited cases.

It must be presumed that Congress, in enacting Section 77 as an integral part of the Bankruptcy Act, intended that the phrase "exclusive jurisdiction of the debtor and its property wherever located" should be given the same meaning as had repeatedly been given to substantially identical

phrases by this and many other courts when dealing with the jurisdiction of the court in ordinary bankruptcy proceedings. *"The Abbotsford,"* 98 U. S. 440, 444 (1878); *Thorn* v. *Browne,* 257 Fed. 519, 523 (C. C. A. 8th, 1919); *Baltimore & Philadelphia Steamboat Co.* v. *Norton,* 40 F. (2d) 530, 531 (E. D. Pa., 1930), aff'd 48 F. (2d) 57 (C. C. A. 3d, 1931), mod. and aff'd 284 U. S. 408 (1932).

But, apart from the foregoing, the phrase in question clearly does not give to the court in a proceeding under Section 77 power to enjoin the sale of pledged collateral.

As pointed out (pp. 21-29, *supra*), there are two reasons why a bankruptcy court in an ordinary proceeding is without power to enjoin the sale of pledged collateral: (1) because by the Bankruptcy Act itself (§§67 (d) and 57 (h)) the lien of the pledgee and his rights to enforce the same are preserved, and (2) because the only property over which the bankruptcy court obtains jurisdiction is that actually or constructively in the possession of the bankrupt when the petition was filed.

Thus, even if it be assumed for argument that the phrase in question was intended to confer some wider or different jurisdiction upon the court in a proceeding under Section 77 than it possesses in an ordinary bankruptcy proceeding, such phrase does not confer power to enjoin the sale by a pledgee of validly pledged collateral, since it manifests no legislative intent: (1) to amend Sections 67 (d) and 57 (h), under which the pledgee is entitled notwithstanding bankruptcy of the pledgor to assert all rights given him by the pledge agreement,[11] or (2) to give to the

[11] On the contrary, by Section 77(g) (6), Section 57(h) is expressly made applicable "to the *appraisal of securities under this section*" (see Appendix to R. F. C. brief, p. 102).

court in a proceeding under Section 77, control over property not in the actual or constructive possession of the debtor when the petition under that section is filed. Plainly, the words "wherever located" refer to the *location* of the property, in a geographical or territorial sense, and not to the *possession* of the property.

By long accepted construction, a bankruptcy court's "exclusive jurisdiction" over property of the bankrupt "wherever found" or "wherever situated" has been held to mean jurisdiction only over property in the possession of the bankrupt. No valid reason—grammatical or otherwise—appears why the words "wherever located," as used in Section 77 (a), should be given a different meaning.

It is significant that Section 77 (n), guaranteeing to creditors that, so far as consistent with the other provisions of that section, their rights shall be the same as in an ordinary bankruptcy proceeding, was added after the bill (containing the phrase "jurisdiction of the debtor and its property wherever located") had passed the House. (76 Cong. Rec., pp. 2905-2907, 2931, 5104-5106.)

Support for petitioners' contention is found in cases construing Section 74 (m)—enacted with Section 77 as part of one act—which provides (p. 93, *infra*), that:

> "The filing of a debtor's petition or answer seeking relief under this section shall subject the debtor *and his property, wherever located, to the exclusive jurisdiction of the court* . . ."

This language, substantially identical with that of Section 77 (a), has been construed by the courts—including the court below—as vesting the court with jurisdiction only over property in the actual or constructive possession of the debtor at the time of the filing of a petition under Section 74. *In re Hillmert*, 71 F. (2d) 411 (C. C. A. 7th, 1934),

cert. den., No. 223, Present Term; *In re Chaiken*, 10 Am. Bank. Rev. 14, 16 (M. D. Pa., 1933); *In re Doelger*, 6 F. Supp. 776 (S. D. N. Y., 1934). See also *In re Parmenter*, 70 F. (2d) 929, 935-936 (C. C. A. 7th, 1934), cert. den., No. 236, Present Term.

4. Section 2 (15) of the Bankruptcy Act does not vest the court in a proceeding under Section 77 with jurisdiction to restrain a pledgee from selling validly pledged collateral.

Respondents concede there is no express authority in Section 77 for the issuance of the injunction, but contend (Br. in Opp., pp. 10-11) that the injunction was "necessay" in order to consummate a plan of reorganization and that therefore the court possessed power to enter the injunction under Section 2 (15) which provides (p. 91, *infra*) that:

> "courts of bankruptcy • • • are invested, • • • with such jurisdiction • • • as will enable them • • • to • • • (15) make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this Act; • • •"

We deny that the injunction was necessary in order to permit the consummation of a plan of reorganization (Point II, pp. 49-60, *infra*), but, even if it were, respondents' contention is not well founded.

Although, by Section 77 (n), Section 2 (15) is made applicable to proceedings under Section 77, so far as consistent with the provisions thereof, Section 2 (15) does not give to a court proceeding under Section 77 a greater *jurisdiction* in the matter of restraining the sale of pledged collateral than it would have apart from Section 2 (15).

Section 2 (15) has been uniformly construed as a grant of "incidental powers." (See *Bardes* v. *Hawarden Bank*, 178 U. S. 524, 535 (1900).) Its effect is stated by *Collier on Bankruptcy* (13th ed., 1923), page 107, as follows:

> "Subdivision 15 • • • is the omnibus clause of the section. Generally speaking, it may be availed of to compel anything which ought to be done for, or to prevent anything which ought not to be done against, the enforcement of the law; *provided the court of bankruptcy otherwise has jurisdiction of the person or the subject-matter.*"

Similar statements appear in *Seaboard Small Loan Corporation* v. *Ottinger*, 50 F. (2d) 856, 857 (C. C. A. 4th, 1931); *In re Hammond*, 98 Fed. 845, 853 (D. Mass., 1899); *In re Donnelly*, 188 Fed. 1001, 1003 (N. D. Ohio, 1910); *In re Hicks*, 133 Fed. 739, 746 (N. D. N. Y., 1905); *In re Swofford Bros. Dry Goods Co.*, 180 Fed. 549, 553 (W. D. Mo., 1910).

In *Ginsberg & Sons, Inc.* v. *Popkin*, 285 U. S. 204 (1932), the Court, speaking of Section 2 (15), said (p. 208), that:

> "General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment."

The rights of a pledgee, after bankruptcy of the pledgor, are specifically dealt with in Sections 67 (d) and 57 (h).

In *In re Browne*, 104 Fed. 762 (E. D. Pa., 1900), wherein the court refused to enjoin the sale by a pledgee of wool pledged to secure notes of the bankrupt, the court said (p. 763) with, respect to Section 2 (15) and another provision, that such clauses:

> "• • • must, of course, be read in connection with the rest of the statute, and are necessarily qualified

> by such provisions as are to be found in clause 'd' of section 67, concerning liens, and by clause 'h' of section 57, concerning the method of ascertaining the value of securities held by creditors."

See also *In re Ward*, 104 Fed. 985, 987 (D. Mass., 1900).

In the court below respondents relied chiefly upon *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2nd, 1911), *In re Purkett, Douglas & Co.*, 50 F. (2d) 435 (S. D. Cal., 1931), and *In re Collier*, 4 F. Supp. 700 (S. D. N. Y. 1933), to sustain their construction of Section 2 (15). A reference to the first two of those cases, which are elsewhere herein discussed (pp. 18, 33-34, *supra*), will show that in neither case did the court base its action upon Section 2 (15). The third case illustrates clearly our contention that Section 2 (15) is operative only when the court otherwise has jurisdiction of the subject matter.

That Section 2 (15) does not confer upon the District Court power to enter the injunction would seem necessarily to follow from the fact that that section has never in the past been construed to authorize a bankruptcy court to restrain the sale of pledged collateral.

Respondents, however, argue that the primary purpose of the ordinary bankruptcy proceeding is *liquidation* of the estate, whereas the primary purpose of a proceeding under Section 77 is *reorganization* of the estate. And they argue that a restraint upon the sale of pledged collateral is not "necessary" where the court is engaged in *liquidating* an estate, but is "necessary" (when the collateral consists of bonds of the debtor) where the court is engaged in *reorganizing* the estate.

This contention is unfounded because (a), as shown above, Section 2 (15) is not a source of jurisdiction; it is operative only if "the court of bankruptcy otherwise has

jurisdiction of the person or the subject matter," (b) the record does not establish that the injunction was necessary for the accomplishment of a plan of reorganization (Point II, pp. 49-60, *in a*), and (c) there is no such distinction between a bankruptcy *reorganization* proceeding (under Section 77 or Section 77-B) and the ordinary bankruptcy *liquidation* proceeding as requires, especially by implication, a power in the former which the courts have held not to be necessary, or even desirable, in the latter.

That a restraint upon the sale of pledged collateral is not "necessary" in a bankruptcy liquidation proceeding is proved by the fact that many such proceedings have been successfully consummated without such restraint, even though creditors might have received larger dividends if an injunction had been granted. Upon what theory, then, is such restraint to be deemed necessary to a successful *reorganization* of a debtor? Many successful reorganizations have been consummated *in equity* in the past without such restraint, and presumably at least some of the corporations so reorganized had pledged their own obligations as security for loans (cases, pp. 19-20, *supra*).

5. The legislative history of Section 77 negatives any intent to clothe the court with the jurisdiction asserted by the District Court.

While there is no ambiguity in Section 77 as to the point at issue, we point out that the legislative history of that section sustains petitioners' contentions.

When Congress enacted Section 77, it was well aware of the distinction between property in the possession of the bankruptcy court and that in the possession of secured creditors, for in Section 74 (h) (which, unlike Section 77,

contains a provision for extending the time of payment of debts, both unsecured and secured), it provided (see Appendix to R.F.C. brief, pp. 88-89) for extending the time of payment of secured debts—

> "the security for which is in the actual or constructive possession of the debtor * * *."

The phrase quoted was not in the bill as originally passed by the House, but was subsequently added, the change being explained by the Senate Judiciary Committee (S. Rept. No. 1215, 72d Cong., 2d Sess., p. 5) as follows:

> "* * * It was believed that if every form of collateral that was deposited as a security for a loan should be subjected to review by the court in any proceedings under this act that it could but result in a greater value of collateral being required by the person or institution granting the loan in the first instance. The tendency would be to further restrict credit."

See also *In the matter of Charles P. Doelger,* 9 Am. Bank. Rev. 329 (S. D. N. Y., 1933).

That Congress did not intend to interfere with the right of a creditor to realize upon pledged security in his possession is borne out by a discussion on the floor of the House with respect to the effect of the bill which became Section 77 upon the rights of the R.F.C., which had loaned some $300,000,000 of public money to the railroads. Certain members of Congress were desirous of making certain that the security held by the R.F.C. should not be impaired by the proposed act. (76 Cong. Rec., pp. 5127-5128, 5359.) In this connection, the following statement was made by Mr. Summers, who was sponsoring the bill in the House (76 Cong. Rec., p. 2909):

"Mr. Garber: What will be the preferential status given loans made by the government to the railroads, over investments in stock and bonds?

"Mr. Sumners: They are not given by this bill any preferred status which they do not now have and to whatever degree now preferred the status is not lessened. They are not disturbed."[12]

The effect of the decision of the court below is to give to a bankruptcy court in a proceeding under Section 77 a jurisdiction (in the matter of enjoining the sale of pledged collateral) wholly at variance with that possessed by such court in the ordinary bankruptcy proceeding, and, so far as the business world is concerned, the decision overturns a rule of law which has stood unquestioned for many years. Moreover, as later brought out in detail, the effect of the decision is summarily to deprive petitioners of substantial property and contract rights. In the light of these facts this Court must assume, we submit, that if Congress had intended that the court should have power to enjoin the sale by pledgees of collateral in their possession, it would have indicated such intent by apt words.

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[12] It is significant that in a document called "Criticisms and Suggestions Relating to H. R. 14359, and S. 5551, Amending the Bankruptcy Act" (Senate Judiciary Committee Print, 72nd Cong., 2d Sess., p. 95), is printed at least one proposed plan for railroad reorganizations which expressly includes the right to enjoin pledgees from realizing upon the pledged collateral.

II.

The record affords no basis for the conclusion of the District Court that the injunction was necessary for the enforcement of Section 77.

If, as we contend, the District Court was without authority to issue the injunction, a consideration of the effect of a sale of the collateral upon the preparation and consummation of a plan of reorganization would seem to be quite irrelevant. If Section 77 does not expressly or by necessary implication authorize the injunction, such authority cannot be predicated upon considerations of expediency or necessity. *A fortiori,* such authority cannot be predicated upon such considerations when Section 77, fairly interpreted, *inhibits* the issuance of such an injunction. Cf. *Crooks* v. *Harrelson,* 282 U. S. 55, 60 (1930); *Chung Fook* v. *White,* 264 U. S. 443, 445 (1924).

But, since respondents sustain the injunction upon the theory that, under Section 2 (15), the court had power to enter *any* order which "was necessary to prevent the proceeding from becoming abortive" (Br. in Opp., p. 10), we emphasize the fact that there is no basis for the contention that the injunction was "necessary" for the consummation of a plan of reorganization.

Although the District Court made no findings, the injunctional order contains certain recitals, and the *conclusions* of the court that a sale of the collateral would "in effect prevent the *orderly* preparation and consummation of a plan of reorganization," and that an injunction against the sale of the collateral pending the "preparation and consummation" of a plan was "necessary for the enforcement of the provisions of Section 77" (R. 103-104).

We do not know what the court meant by the phrase "*orderly* preparation and consummation of a plan of reorganization," nor is it apparent that an order which is necessary for the "*orderly* preparation, etc.," is one which was "necessary for the enforcement * * * of Section 77." We shall, however, treat the conclusion of the court as a holding that the injunction was necessary in order to permit the consummation of a plan.

We contend, for reasons hereinafter set forth, that the statements above quoted from the injunctional order are *not findings of fact but conclusions of law;* and further, that even if they are findings of fact, there was *no evidence* before the court upon which it could make such findings.

No evidence whatever was presented to the District Court as to the effect of the sale of all or part of the pledged collateral upon a plan of reorganization, or otherwise. The record on which the injunction was entered consists of (1) the Debtor's petition (R. 37-43), (2) the affidavit of Dwight S. Beebe (R. 65-68), (3) the answer of the General Mortgage Protective Committee (R. 59-63), (4) and the affidavits filed by the non-resident banks (R. 69, 73, 100). Only the first two of these have any bearing on the point under consideration.

The only grounds for an injunction asserted in the Debtor's petition are (R. 40-41; and see R. 315-316) that—

> (1) The value of the collateral securing each of the Debtor's collateral loans is substantially in excess of the amount of the loan.
>
> (2) If the holders of the Debtor's notes should sell the same, it would cause a "substantial and irreparable loss to the trust estate."

(3) A "forced sale" of said collateral "at the present time * * * *might* result in a substantial deficiency judgment against the Debtor," and "would dilute the respective interests in the trust estate" of the other holders of bonds similar to those held by petitioners, of other creditors, and of the Debtor itself.

Giving these allegations—only the first of which is an allegation of *fact*—their widest scope, all they establish is the possibility that a forced sale of the collateral (1) might result in a substantial deficiency judgment, and (2) would "dilute" the interest of other bondholders and creditors. *But there was no evidence before the court, and the court was not in a position to assume, that a substantial deficiency judgment against the Debtor and a "dilution" of the interests of the other bondholders and creditors would hinder or prevent the preparation and consummation of a plan of reorganization.* Accordingly, the Debtor's petition affords no basis whatever for the holding of the District Court (R. 104) that an injunction was "necessary for the enforcement of the provisions of Section 77."

The only pertinent allegations in the Beebe affidavit are:

(1) There are pledged with Trustees under three of the Debtor's mortgages $102,860,000 face amount of bonds and $32,889,050 face amount of capital stock of the "Debtor's System" (R. 66).

(2) "* * * In certain events described in the Indentures under which the aforesaid Trustees are acting, such Trustees are given the right to sell such collateral" (R. 66-67). [What such "certain events" are does not appear, and the "Indentures" were not presented to the court.]

(3) A decision that the pledgees should not be enjoined from selling the collateral held by them would also determine that the "Trustees of the three Bond issues mentioned above had the right to sell * * * the $145,749,050 total face amount of capital obligations of the System pledged with them" (R. 67).

(4) "The *position* of this Committee * * * is that the interests of the bondholders * * * and of the Debtor's estate generally would best be served * * * by a decision requiring all holders of secured claims to retain their collateral until a plan of reorganization is prepared, approved and put into effect" (R. 67).

(5) "The *contentions* of the Committee are * * * that it is essential to enjoin such sales * * *" (R. 68).

Patently, we submit, none of these statements (only the first two of which are allegations of *fact*) affords any basis for a holding that a sale of the collateral would prevent the consummation of a plan of reorganization, or that an injunction was necessary for the enforcement of Section 77. Cf. *Missouri Pacific R. Co.* v. *Norwood,* 283 U. S. 249, 254 (1931).

Nor is there anything in the opinion of the Circuit Court of Appeals which establishes the alleged necessity. The *only statements in the opinion on this point* are (R. 324-325):

> "In the instant case some fifty-four millions of dollars of the debtor's and its subsidiaries' bonds were hypothecated with creditors whose claims were scarcely one-third that amount. To successfully reorganize, it is necessary to take care of the funded indebtedness amounting to approximately two hundred and eighty millions of dollars. If, in addition thereto, fifty-four million dollars of bonds were beyond the control of the court, it would be quite impossible to proceed with any reorganization.
>
> * * * * * * *

"* * * Without some control over the disposition of $54,000,000 of bonds which have been hypothecated to secure nearly $18,000,000 of indebtedness, the presentation of a satisfactory plan of reorganization might as well be abandoned."

What is meant by the statement that without an injunction the pledged bonds would be "beyond the control of the court" is not apparent. In any event, there is not a scintilla of evidence to support the statement that "Without some control over the disposition of $54,000,000 of bonds * * * the presentation of a satisfactory plan of reorganization might as well be abandoned." In fact, there was no evidence at all (1) as to what kind of plan would be "satisfactory," (2) as to facts and conditions which must exist before a "satisfactory plan," or any plan, may be prepared or consummated, (3) as to what would be the effect of the asserted lack of "control" over the pledged bonds, or (4) that a plan could be consummated if an injunction were issued, but could not without an injunction.

Moreover, the fallacy of the court's statement is apparent, apart from the lack of supporting evidence.

Other than the pledged bonds, the Debtor has outstanding—in the hands of the public—bonds in excess of $280,000,000 (R. 318). No injunction has been issued against the "disposition" of these bonds; they are sold daily upon the stock exchanges, and the District Court has no control over their "disposition". Upon what basis is control over the disposition of $54,000,000 of pledged bonds absolutely vital before a plan can be even "presented," when the court is equally without "control" over the disposition of $280,000,000 of like bonds held by the public?

Respondents are thus committed to the contention that, in a proceeding under Section 77, the court must always and necessarily find—and without any evidence being presented—that an injunction is "necessary" for the consummation of a plan of reorganization *where the debtor has pledged a substantial amount of its own bonds in a face amount in excess of the debts which they secure.* If the fallacy of such contention is not apparent on its face, it is easily demonstrable.

Just what effects do respondents assert a sale of the pledged collateral will have upon a reorganization?

In the District Court respondents argued (see also Br. in Opp., pp. 10-11, 14) that such sale would (1) *dilute* the interests of the other holders of outstanding bonds of the Debtor and (2) increase the outstanding indebtedness of the Debtor. They argued thus: The Chase National Bank holds the Debtor's note for $2,000,000, secured by $7,209,000 face amount of bonds ($3,253,000 of the Debtor's First and Refunding bonds and $3,956,000 of Short Line Bonds); if the Bank should sell the collateral for, say, $1,000,000, it would still have a claim against Debtor for $1,000,000, and the purchasers of the bonds would have a claim against the "Debtor's System" for $7,209,000; a claim against the Debtor of $2,000,000 is thus transformed into one of $8,209,000. (See Br. in Opp., p. 6.)

In the Circuit Court of Appeals, some of the respondent Committees (referred to herein as the First and Refunding Group) adhered to this argument, but other Committees (referred to herein as the General Mortgage Group) advanced a wholly new and conflicting theory. This second group contended that as a matter of law the pledgees *could not sell the pledged bonds!* They argued that, under the

Bankruptcy Act, the rights of creditors are fixed as of the commencement of the proceeding; that a creditor holding mortgage bonds of the bankrupt may not prove a claim upon the pledged bonds, but may only prove a claim upon the debts secured; that the only purpose of the pledged bonds is to represent the pledgee's fractional interest (held as security only) in the lien of the mortgage; and that under Section 77, as an integral part of the Bankruptcy Act, the pledgee banks could not—after the filing of the Debtor's petition—transfer to another anything more than the pledgees themselves had when the proceeding was commenced.

This latter argument, if sound, establishes that there would be (a) no "dilution" of the rights of other bondholders, and (b) no increase in the Debtor's indebtedness, upon the sale of the pledged collateral, and thus nullifies completely the theory upon which the injunction was sought (R. 40) and issued (R. 103). So, in order to sustain the injunction, the General Mortgage Group argued that the court possessed, and rightfully exercised, *the power to bar creditors from splitting up their claims, or from splitting up and transferring interests, held as collateral, in the Debtor's estate!*

Which of these two diametrically opposed views is correct[13] need not be here determined since, on either view,

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[13] See foot-note 5, page 20, *supra;* foot-note 15, page 57, *infra;* but see also Hatch, "A Form of Depression Finance—Corporations Pledging Their Own Bonds," 47 Harv. L. Rev. 1093. As to the contention of the General Mortgage Group that only claims against the debtor which are due and owing on the date the petition under Section 77 is filed may participate in the reorganization, see Section 77 (b), which defines the word "creditors" as including "all holders of claims, interests, or securities of whatever character against the debtor or its property * * * *whether or not such claims, interests, or securities would otherwise constitute provable claims under this Act.*" (See Appendix to R. F. C. brief, pp. 93-94.)

there is no basis upon this record for a holding that the injunction was necessary in order to permit of a plan of reorganization. Assuming, for argument, the correctness of the basic premises of the First and Refunding Group,[14] they utterly fail to show that a sale of the collateral would render the consummation of a plan of reorganization impossible, or even improbable.

Of what relevancy are the assumed facts that upon a sale of the pledged collateral (1) the interests of other bondholders and creditors would be "diluted," (2) the outstanding indebtedness of the Debtor would be increased, and (3) the amount of new securities which must be provided for in any plan will be increased and the nature thereof affected (see Br. in Opp., p. 8), in the lack of proof of any kind that these facts *would so affect the capital structure of the Debtor, or otherwise produce such a situation, as to prevent a reorganization?* Surely the court was not entitled to *assume* that such facts would produce such

[14] There is, of course, no *real* difference between a sale of pledged collateral consisting of bonds of a third party and a sale of pledged collateral consisting of bonds of the bankrupt. A sale of the former may result in wiping out a substantial equity of the bankrupt, with the result that the interests of all other creditors are "diluted," *i. e.*, they will receive less than they would if a sale of the collateral had been restrained until the collateral could be sold at a higher price, or until the bankrupt's trustee might be able to redeem the same. *And this is all that happens where the pledgee sells pledged bonds of the bankrupt*, except that in the latter case the "dilution" might be greater than in the former.

In the instant cases, the asserted "dilution" and "increase of indebtedness" is more fanciful than real, at least in the entire absence of proof (a) that the value of the pledged collateral is in excess of the claims secured thereby (which is clearly not so at the present time; see p. 12, *supra*), and (b) that a wholly unsecured claim against the Debtor possesses substantial value.

The validity of the pledges is conceded, and therefore, even if the injunction stands, the pledged collateral will have to be provided for in any plan of reorganization to the same extent (to the amount of the Debtor's notes held by petitioners) as other bonds

a result, especially at a time when no one had any idea as to what kind of plan, if any, would be feasible.

It is therefore submitted that, admitting (for argument) every premise of the First and Refunding Group, the District Court had not even a scintilla of evidence before it which would justify its holding that, unless the injunction were entered, it would be impossible to consummate *any plan* of reorganization.

Similarly, as to the theory of the General Mortgage Group. We dispute the contention that, upon the filing of Debtor's petition under Section 77, petitioners became and are now unable, as a matter of law, to sell the pledged collateral as such,[15] a contention plainly without merit as to

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of the same kind held by the public generally. It was conceded in the court below by all the respondents that petitioners, as pledgees, would be entitled in any plan of reorganization, to realize—to the full amount of the Debtor's notes held by them—upon the pledged bonds, *i. e.*, upon the mortgaged assets underlying the bonds. (See Br. in Opp., pp. 7-8.) This much was conceded even by the court in the *Mississippi Valley Trust Company* case. (See 258 Fed. 346, at p. 354.)

In other words, even if a sale of the pledged collateral would increase the total general claims against the Debtor, in the entire absence of proof of the facts (a) and (b) above, a purchaser of the pledged bonds would acquire no greater interest in the Debtor's assets—*i. e.*, those securing the pledged mortgage bonds—than must eventually be accorded to petitioners as pledgees thereof, *assuming no sale of the pledged collateral.*

It may also be pointed out that the "dilution" argument has no application whatever to the Short Line bonds, which constitute about 60% of petitioners' collateral (R. 30). Such bonds are secured obligations of *a third party*. Even though the Debtor may have guaranteed the payment of such bonds (see R. 20), there would be no "dilution" of the rights of other creditors upon a sale of the pledged collateral, since the Debtor can require the Short Line Company to reimburse it for any payments it might be compelled to make upon its guaranty.

[15] We do not consider this question relevant, and it would require a complete additional brief to answer the various contentions in this respect made in the court below by the General Mortgage Group.

the Short Line bonds (*i. e.*, bonds of a third party) held by petitioners. But assuming, for argument, that petitioners cannot sell the pledged bonds as such, but have only a right to assign their claims (with the security) against the Debtor, and assuming further that if there were no injunction, petitioners might assign *part* of their claims, or assign all thereof, *to several persons*, with the result that said claims are split up, these facts do not—in and of themselves, and *with no evidence as to the probable, if any, effect thereof upon the working out of a plan of reorganization*—warrant a holding that no plan could be consummated unless an injunction were entered.[16]

It must be remembered that respondents' contentions are predicated on the theory that the injunction was "neces-

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Many of the pertinent authorities are cited in foot-note 5, page 20, *supra*.

It may be pointed out that this Court has held that bankruptcy does not invalidate a pledgee's right to sell mortgage bonds of the bankrupt pledged by it. *Jerome v. McCarter*, 94 U. S. 734, 739 (1876). That decision was followed in *In re Ironclad Mfg. Co.*, 192 Fed. 318 (C. C. A. 2d, 1912), in which the court denied an injunction restraining a sale of a bankrupt corporation's pledged bonds. In *In re Battle Island Paper Co.*, 259 Fed. 921 (N. D. N. Y., 1919), a pledgee of such bonds was permitted to sell them to itself, credit its *pro rata* share of the proceeds of the foreclosure of the mortgage securing the bonds upon its claim, and prove a deficiency claim *based upon the face amount of the bonds*. In *Turner* v. *Metropolitan Trust Co.*, 207 Fed. 495 (C. C. A. 9th, 1913), it was held that, in so far as a pledgee's right to dispose of pledged collateral is concerned, a pledge by the *bankrupt* of its own secured obligations is to be treated exactly as is a pledge of the obligations of a third party. A like rule prevails in equity with respect to a pledge by an *insolvent* corporation of its own secured obligations. *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475 (E. D. Pa., 1921).

[16] The contention that a plan of reorganization could not be worked out if "classes of creditors are being changed all the time" (as asserted by the General Mortgage Group in the court below) is,

sary" to enable the consummation of a plan (Br. in Opp., pp. 10-11, 14). Accordingly, while it may not have been necessary for respondents to show that if the injunction were issued a plan *could be consummated*, it was clearly incumbent upon them to make a *prima facie* showing that, unless an injunction were entered, *a plan could not be worked out*. It would not be enough to show merely that any plan of reorganization which might be devised if there were no injunction might, or would necessarily, be *a different plan* from that which might be devised if the injunction were granted.

Moreover, while Section 77 contemplates a plan of reorganization for the Debtor, it clearly does not and could not guarantee any particular kind of plan or that any particular plan will be practicable. (See H. Rept. No. 1897,

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with all deference to the learned counsel, wholly without substance. If the Debtor has issued and outstanding 1,000 of its X bonds, the holders of such bonds constitute one class of claimants. (See Order No. 37 of the District Court, Appendix to R. F. C. brief, pp. 133-142.) If A, owning two of such bonds, assigns one each to B and C, the "class" of creditors is not changed; B and C are merely substituted within the class for A. That bankruptcy does not prevent a creditor from *assigning* his claim is elemental. (See General Orders in Bankruptcy, Rule XXI.)

If a splitting of claims would prevent a reorganization (and there is no evidence to this effect), it would be necessary to enjoin all holders of the Debtor's securities (totaling over $280,000,000, in face amount) from selling them. Large blocks of the Debtor's securities are sold daily upon the stock exchanges, but it has never been suggested that this fact would make a reorganization impossible. As a matter of fact, the court could not prevent the splitting of claims, since claims are constantly being divided by operation of law, *e. g.*, by death and distribution.

If the courts below had predicated the injunction upon the necessity of preventing a "splitting up of claims" against the Debtor, or of preventing a "change" in the "classes of creditors," petitioners would only have been enjoined from selling the pledged collateral *in parcels* or *to more than one purchaser*. Such a restraining order would have accomplished all that the General Mortgage Group assert was sought to be effected by the injunction in the instant cases.

72nd Cong., 2d Sess., p. 5.) Nor does it provide for a plan which will be acceptable or preferable to any class of creditors as opposed to another class; or that creditors in possession of pledged collateral should relinquish their favored position—for which presumably the Debtor received full consideration—for the benefit of creditors who do not have any security in their possession, or any security at all. Indeed, Section 77 does not even require that a proceeding under that section must result in *reorganization* (see Section 77(c) (7); Appendix to R. F. C. brief, p. 95).

While the record before the District Court might perhaps warrant a holding that the terms or details of any plan of reorganization, in the event of a sale of the collateral, might be, or even necessarily must be, *different* from any plan which would be worked out in the event the collateral were not sold, the record affords no basis whatever for a determination that *no* plan of reorganization could be consummated unless a sale of the collateral is prevented.

III.

Section 77 as construed by the Circuit Court of Appeals deprives petitioners of preexisting vested property rights without due process of law in violation of the Fifth Amendment.

By Section 2 of the Act of March 3, 1933, c. 204, 47 Stat. 1467, Section 77 is expressly made applicable to creditors "whose interests or debts, whether secured or unsecured," were acquired or incurred prior to the effective date of that section.

The court below held that Section 77, as construed and applied by it in the instant cases, did not violate the Fifth

Amendment because (R. 326) "the order of sale deals merely with the remedy" of petitioners. Petitioners, however, contend (1) that the injunctional order deprives them not merely of a remedy, but of a substantial, substantive right; and (2) that even if such order is held to be one which affects merely petitioners' remedy, it was an unreasonable and arbitrary modification and postponement of such remedy, and that, accordingly, on either theory, the order deprives petitioners of property in violation of the Fifth Amendment.

The basic purposes of a bankruptcy law are (1) distribution of the debtor's property among his creditors and (2) the discharge of the debtor from liability to pay his debts.[17] Both such purposes may be accomplished without necessarily disturbing the lien of a creditor holding collateral validly pledged to him by the bankrupt.

That is to say, bankruptcy need not disturb a valid lien on pledged collateral in the possession of a creditor in order (1) to discharge the debtor from his debt, or (2) to fully distribute the debtor's property among his creditors, since the debtor only has (a) a right to redeem the collateral, prior to sale by the pledgee, upon payment of the debt and

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[17] In *Matter of Klein* (note to *Nelson* v. *Carland*, 1 How. 265, 277 (1843)), Mr. Justice Catron said:

> "I hold, it [the bankruptcy power] extends to all cases where the law causes to be distributed, the property of the debtor among his creditors; this is its least limit. Its greatest, is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress."

(b) an interest in any portion of the collateral, or the proceeds thereof, remaining after collection of the debt.

A bankruptcy act may, of course, void liens which would, but for the act, be valid, if such liens were created under circumstances which would constitute the transaction preferential or of a character which would defeat the primary purpose of all bankruptcy legislation, namely, the pro rata distribution of the debtor's assets among his creditors. But it has never been suggested that a bankruptcy act may extinguish non-preferential liens created by the debtor.[18]

Thus, this Court said, in *Mayer* v. *Hellman*, 91 U. S. 496, 501 (1875):

> "The great object of the Bankrupt Act, so far as creditors are concerned, is to secure equality of distribution among them of the property of the bankrupt. For that purpose, it sets aside all transactions had within a prescribed period previous to the petition in bankruptcy, defeating, or tending to defeat, such distribution. • • • *Those periods constitute the limitation within which the transactions will be exam-*

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[18] It is doubtful whether the power of Congress to pass laws on the "subject of bankruptcies" affords authority to prohibit the creation of non-preferential liens or to interfere in any manner with their terms or binding force, whether such liens are created either before or after the passage of the act. This question has not been decided by this Court. (See Louis B. Wehle, *"Railroad Reorganizations under Section 77 of the Bankruptcy Act: New Legislation Suggested,"* 44 Yale L. Jour. 197, 227.) An act which purports to impair valid liens, created by a debtor before or after the effective date of the act, cannot fairly be said to be an act on "the subject of bankruptcies." An act which affected absolute titles validly granted by the bankrupt would certainly not deal with the subject of bankruptcies. Moreover, bankruptcy legislation may not prohibit transfers of property rights and operates only on interests in property remaining in the debtor. See *Hanover National Bank* v. *Moyses*, 186 U. S. 181, 189 (1902).

ined and annulled, if conflicting with the provisions of the Bankrupt Act.

"Transactions anterior to these periods are presumed to have been acquiesced in by the creditors. There is sound policy in prescribing a limitation of this kind. *It would be in the highest degree injurious to the community to have the validity of business transactions with debtors, in which it is interested, subject to the contingency of being assailed by subsequent proceedings in bankruptcy.*"

The instant cases involve liens which are admittedly valid, both under and apart from the Bankruptcy Act (R. 324; Br. in Opp., p. 7). And it is our contention that if the injunction in question (operating as it does to defer *indefinitely* the right to realize a lien on readily marketable securities), is permitted by Section 77, the act deprives petitioners of property without due process of law in violation of the Fifth Amendment.

It is settled that all of the powers delegated to Congress under the Constitution are qualified by and subject to the restrictions of the Fifth Amendment.

This is true, for example, (a) of the war power (*Ex parte Milligan,* 4 Wall. 2, 119 (1866); *Ochoa* v. *Hernandez,* 230 U. S. 139, 153 (1913); *Hamilton* v. *Kentucky Distilleries & Warehouse Company,* 251 U. S. 146, 155, 156 (1919)), (b) of the power to tax (*Brushaber* v. *Union Pac. R. R.,* 240 U. S. 1, 24-25 (1916); *Barclay & Company, Inc.,* v. *Edwards,* 267 U. S. 442, 450 (1924); *Nichols* v. *Coolidge,* 274 U. S. 531, 542 (1927); *Blodgett* v. *Holden,* 275 U. S. 142, 147 (1927); *Heiner* v. *Donnan,* 285 U. S. 312, 326 (1932)), and (c) of the power to regulate Interstate Commerce (*Monongahela Navigation Co.* v. *United States,* 148 U. S. 312, 336 (1893); *United States* v. *Joint Traffic Association,* 171 U. S. 505, 571 (1898); *United States* v. *Lynah,* 188 U. S.

445, 471 (1903); *Carroll* v. *Greenwich Insurance Co.*, 199 U. S. 401, 410 (1905); *Adair* v. *United States*, 208 U. S. 161, 180 (1908); *United States* v. *Cress*, 243 U. S. 316, 326 (1917)).

This Court has expressly declared that the bankruptcy power of Congress is subject to the Fifth Amendment, saying, in *Hanover National Bank* v. *Moyses*, 186 U. S. 181 (1902), that (p. 192):

> "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law, * * *"

Similarly, in *In re William W. Bradford, Jr., Bankrupt*, 7 F. Supp. 665 (D. Md., 1934), Judge Chesnut said (p. 674):

> "The exercise of the bankruptcy power by Congress, as is the case with other delegated powers, is subject to the requirement of the due process clause of the Fifth Amendment."

Legislation on the subject of bankruptcies must, therefore, be reasonable and not arbitrary. (See also *Holt* v. *Henley*, 232 U. S. 637, 639 (1914); *In re Dillard*, 7 Fed. Cas. 703, 704 (C. C., E. D. Va., 1873); *In re Sterba, Debtor*, (C. C. A. 7th), decided January 5, 1935; 48 Harv. L. Rev. 332, 333.)

It is settled that a right given or created by contract is "property" within the meaning of the Fifth and Fourteenth Amendments.[19] *Sinking-Fund Cases*, 99 U. S. 700,

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[19] Cases dealing with the latter amendment are applicable, since the restraint imposed by Congress by the due process clause of the Fifth Amendment is the same as that imposed upon the several States by the like clause of the Fourteenth Amendment. *Sinking-Fund Cases*, 99 U. S. 700, 718 (1878); *Hibben* v. *Smith*, 191 U. S. 310, 325 (1903); *Twining* v. *New Jersey*, 211 U. S. 78, 101 (1908); *Coolidge* v. *Long*, 282 U. S. 582, 596 (1931); *Heiner* v. *Donnan*, 285 U. S. 312, 326 (1932).

718 (1878); *Choate* v. *Trapp*, 224 U. S. 665, 678 (1912); *Highland* v. *Russell Car & Snow Plow Company*, 279 U. S. 253, 261 (1929). In the case of a pledge of marketable securities the very essence of the contract is the right, upon the pledgor's default, to sell the securities at such time as he may choose. (See *In re Hudson River Navigation Corporation*, 57 F. (2d) 175, 176 (C. C. A. 2d, 1932), *supra*.) It follows that a substantial taking of such right, for the benefit of others, falls within the inhibition of the Fifth Amendment.

Nor is the difficulty avoided by the mere statement that the injunction in the instant case deals only with petitioners' remedy. (See R. 326.) It must be borne in mind that the distinction between "right" and "remedy" is one of substance and not of form. As was stated by the Court in *VonHoffman* v. *City of Quincy*, 4 Wall. 535, 553 (1866):

> "• • • No attempt has been made to fix definitely the line between alterations of the remedy, which are to be deemed legitimate, and those which, under the form of modifying the remedy, impair substantial rights. Every case must be determined upon its own circumstances. *Whenever the result last mentioned is produced the act is within the prohibition of the Constitution, and to that extent void.*"

Moreover, this Court has held that a remedy given not by a statute but by the specific terms of a contract is part and parcel of the obligations of that contract, stating in *Bronson* v. *Kinzie*, 1 How. 311, 320 (1843):

> "In the case before us, the conflict of these laws with the obligations of the contract is made the more evident by an express covenant contained in the instrument itself, whereby the mortgagee, in default of payment, was authorized to enter on the premises,

> and sell them at public auction; and to retain out of the money thus raised, the amount due, and to pay the overplus, if any, to the mortgagor. It is impossible to read this covenant, and compare it with the laws now under consideration, without seeing that both of these acts *materially interfere with the express agreement of the parties contained in this covenant.*"

The rights of petitioners as pledgees are derived, not from any statute or rule of law, but from the specific and detailed terms of the several contracts of pledge. In this situation, in the language of the court in *Galey* v. *Guffey*, 94 Atl. 238, 240 (Pa., 1915):

> "• • • the rule is that the remedy becomes part of the obligation of the contract, and any subsequent statute which affects the remedy impairs the obligation, and is unconstitutional."

And even if the general right of a pledgee to sell pledged collateral were a mere matter of remedy, if by the terms of the pledge agreement the pledgee is given an express right to sell in a particular way, that right is a substantive one and any interference with such right is as much an interference with the obligations of the contract as would be interference with any other term thereof. The injunction in the instant cases accordingly affected not merely the remedy afforded the pledgees, but the obligations of the contracts themselves.

Furthermore, since freedom to *carry out or enforce*, as well as to enter into, contracts in respect to property and private affairs is protected by the due process clause of the Fifth Amendment (*Highland* v. *Russell Car & Snow Plow Company*, 279 U. S. 253, 261 (1929)), an unreasonable or

arbitrary impairment of the right to *enforce* a contract deprives persons of a substantial property right, even if such right to enforce is derived solely from a statute and not from the contract itself. Thus, this Court said, in *Louisiana* v. *City of New Orleans*, 102 U. S. 203, 206 (1880):

> "The obligation of a contract, in the constitutional sense, is the means provided by law by which it can be enforced,—by which the parties can be obliged to perform it. *Whatever legislation lessens the efficacy of these means impairs the obligation.* If it tend to postpone or retard the enforcement of the contract, the obligation of the latter is to that extent weakened. * * * Any authorization of the postponement of payment, or of means by which such postponement may be effected, is in conflict with the constitutional inhibition."

The Court, again, in *Lynch* v. *United States*, 292 U. S. 571 (1934), said (p. 580):

> "Contracts between individuals or corporations are impaired within the meaning of the Constitution whenever the right to enforce them by legal process is taken away or materially lessened."

A fortiori, a contract is impaired, within the meaning of the Constitution, whenever the right to enforce it through *extra-legal* action is taken away or materially lessened.

Even if, therefore, it be held that the injunction in the instant cases touched only petitioners' remedy, nevertheless, if the right to enforce the pledge agreements is by the injunction postponed for an unreasonable period or in an arbitrary manner, such postponement is a violation of due process. *Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398, 445 (1934).

In determining whether the injunctional order is an unreasonable modification or postponement of petitioners' right to enforce the pledge agreements it should be noted that Section 77 is not, by its terms, emergency legislation, and the period of its duration is unlimited. The *Blaisdell* case, the reasoning of which applies equally to due process under the Fifth Amendment (see 290 U. S. 398, 448, and footnote 19, p. 64, *supra*), dealt with emergency legislation and is, to a large extent, based on reserved emergency powers. *W. B. Worthen Co.* v. *Thomas,* 292 U. S. 426, 432 (1934). Those decisions, which have permitted the time for enforcement of contracts to be postponed for a limited period under emergency conditions, have been said by this Court to go "to the verge of the law." *Pennsylvania Coal Co.* v. *Mahon,* 260 U. S. 393, 416 (1922).

Resolving all doubts in favor of the restraining order, and assuming for argument that by a bankruptcy act (not enacted as emergency legislation) a court may lawfully be authorized to postpone the enforcement of certain liens for a reasonably limited period, petitioners contend that in the instant cases their right to realize upon the pledged collateral has been unreasonably modified and postponed.

The injunction in question restrains petitioners' right to sell mortgage bonds listed on the New York Stock Exchange, *i. e.,* property, the market value of which fluctuates from day to day, following the law of supply and demand, varying market conditions, the changing financial status of the issuers and the many other circumstances which influence prices in the open market. The pledgees reserved to *themselves* the right to sell the collateral after default at any time *they* deemed proper. They are expressly permitted to choose the day and the hour for sale to the end that they may exercise *their own* best judgment as to the propitious time.

When the Debtor's petition for an injunction was filed (September 26, 1933) the collateral held by petitioners had a market value (based on past prior sales on the New York Stock Exchange) of $4,153,355, an amount substantially in excess of the $3,866,923.34 principal amount of indebtedness then owing to petitioners. On October 15, 1934, when the petition for certiorari was prepared, the market value of the collateral (on the same basis) was $2,614,755. On January 12, 1935, as this brief is being prepared, the market value of the collateral (on the same basis) is $2,389,980. It is apparent, therefore, that *any* postponement of the sale of collateral of the character in question may cause substantial damage to the pledgees—as indeed the injunction in these cases has already damaged petitioners.

A restraint on the right to foreclose a real estate mortgage, even for a long period, may be reasonable because of the non-fluctuating character of the security. We submit, however, that a restraint on the right to sell pledged securities, such as those here involved, for *any* length of time is unreasonable. This proposition is expressed succinctly in *In Re Hudson River Navigation Corporation*, 57 F. (2d) 175 (C. C. A. 2d, 1932), where Judge L. Hand said, with regard to the rule that bankruptcy does not touch the power of a pledgee of securities to close out his collateral (p. 176):

> "Nothing would be more disturbing to transactions of the kind than a doubt thrown upon that ruling. Millions of dollars are daily lent upon like collateral, which fluctuates from hour to hour; *unless the pledgee is free to chose his time to sell, his security may disappear.*"

Moreover, the restraining order is arbitrary and unreasonable even apart from the peculiar character of the collateral involved.

The injunction prohibited the sale of the collateral "until further order of this Court" (R. 104). This language indicates that at some *wholly indefinite* time in the future the order may be vacated and petitioners permitted to exercise their right of sale. Just when this will be, is indicated only by the recital in the order (R. 104) that the injunction was "necessary" for the enforcement of Section 77 "pending the preparation *and consummation* of said reorganization plan." As to when the "preparation and consummation" of a plan will occur, we have only the statement of the court below that such a plan must be "forthcoming with reasonable promptness" (R. 325).

What is the "reasonable promptness" with which a plan must be presented and consummated?

The Debtor's original petition was approved June 7, 1933 (R. 2). The restraining order was entered November 22, 1933 (R. 100), more than five months later, and this order was affirmed July 23, 1934 (R. 326), more than thirteen months after the Debtor's petition was filed. During those thirteen months no plan of reorganization was even proposed. The court below therefore clearly assumed that thirteen months was not an unreasonable time within which to *present* a plan of reorganization; and we concede that a plan of reorganization of a transcontinental railroad system cannot be formulated, in the nature of things, within any short period of time. If thirteen months is not an unreasonable time in which to present a plan, there is no reason to believe that the court below would determine that two or three or more years are unreasonable.

As a matter of fact, no plan has *as yet been even proposed*, notwithstanding nearly two years have elapsed since the filing of the Debtor's petition, and very recently the Debtor's Trustees advised the Interstate Commerce Com-

mission that there is no likelihood of any plan being formulated in the immediate future. (See Appendix to Brief of R. F. C., pp. 167-173.)

Even after a plan has been formulated, and before it can be voted upon by the creditors and stockholders, the Interstate Commerce Commission must hold a public hearing thereon. Thereafter, it must submit a report with respect thereto, whereupon the plan and report must be submitted to the creditors and stockholders (Section 77 (d); see Appendix to R. F. C. brief, pp. 97-98). If the creditors and stockholders should vote to accept a plan different from the one approved by the Commission, the new plan must be referred back to the Commission (Section 77 (f); see Appendix to R. F. C. brief, pp. 100-101) for another public hearing; and finally the plan must be submitted to the court for its approval (Section 77 (g); see Appendix to R. F. C. brief, pp. 101-102). It is thus obvious that several years may elapse between the time a plan is initially formulated and its final approval by the court, without counting further delays which may arise in the event of an appeal from the decision of the court. (See Wehle, "Railroad Reorganization Under Section 77 of the Bankruptcy Act: New Legislation Suggested," 44 Yale L. Journ., 197, 202-204).

What, then, constitutes the "reasonable promptness" to which the court below refers? How long is a "reasonable" time for plan to be in the tortuous process of approval (by the Interstate Commerce Commission, by the creditors and stockholders, and by the court)? It is obvious, we submit, that no *definite* answer can be given to such questions. The result is that the petitioners' rights to realize upon their pledges have been suspended for an undeterminable and indefinite time—and a time not limited to any emergency—during which the value of such rights

may largely disappear, as in fact it has already largely disappeared. Such a result is clearly a taking of petitioners' property, which cannot be justified by the nice, but wholly erroneous, statement that the District Court dealt "merely with the remedy" of petitioners. *W. B. Worthen Co.* v. *Thomas*, 292 U. S. 426, 434 (1934). See also *Barnitz* v. *Beverly*, 163 U. S. 118 (1896); *Hanauer* v. *Republic Bldg. Co.*, 255 N. W. 136 (Wis., 1934); *Vanderbilt* v. *Brunton Piano Co.*, 169 Atl. 177 (N. J., 1933).

In any event, no limitation on the right of petitioners to sell the pledged collateral could be more arbitrary than one dependent upon the individual discretion of a judge *where no standards for the exercise of such discretion are set up by the statute.* Cf. *Panama Refining Co.* v. *Ryan*, No. 135, Present Term. The injunction substitutes the discretion of the judge as to the time at which a sale will be for the best interests of all concerned (including the Debtor and other creditors) for the vested contract right of petitioners to exercise their own judgments as to the time at which a sale will be for the best interests, not of all concerned but, of petitioners alone.

Under the Fifth Amendment, the taking of property from one owner and giving it to another is also prohibited. *Ochoa* v. *Hernandez*, 230 U. S. 139, 161 (1913); *Loan Association* v. *Topeka*, 20 Wall. 655, 662, 664 (1874); *Chicago, Burlington & Quincy Railroad Co.* v. *Chicago*, 166 U. S. 226, 235 (1897) and *Missouri Pacific Railway* v. *Nebraska*, 164 U. S. 403, 417 (1896). The avowed purpose as well as the actual effect of the restraining order is to take away from petitioners their right to sell the pledged collateral, in order to benefit the other creditors of the Debtor and even the Debtor itself, since the Debtor's title to its property may be retained by it even after a reorganization under the provisions of Section 77. (See Section 77 (j); Appendix to R. F. C. brief, p. 104). The Cir-

cuit Court of Appeals itself recognized this "taking" when it said (R. 325):

> "*Balancing equities*, we find the court wisely sought to protect the great mass of debtor's creditors without injuring the position of appellants. • • •"

It is thus clear that the District Court was seeking to protect the Debtor's other creditors, but the court could not possibly give this protection without materially "injuring the position of appellants."

The instant cases are readily distinguishable from cases where this Court and other courts have sustained injunctions prohibiting the prosecution of suits to foreclose real estate mortgages, instituted after or within four months of the filing of petitions in bankruptcy. In that class of cases, foreclosure may be had in the bankruptcy court as effectively as in any other court; and the effect of the injunction is merely to substitute one forum for another. In such cases the mortgagee's right to sell the property is not denied, but permitted, and presumably the foreclosure will be carried out quite as satisfactorily in the bankruptcy court as in some other court. The theory of such cases, as poinfed out in *Allebach* v. *Thomas*, 16 F. (2d) 853 (C. C. A. 4th, 1927), which case was relied upon by the court below (R. 326), is that the mortgagee's contract is not impaired by the alteration of the remedy "so long as an equally adequate remedy is afforded" (p. 855). In the instant cases the petitioners are not given an adequate substitute for the right of which they have been deprived.[20]

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[20] It should be noted that petitioners have received no interest on their notes since the restraining order was entered (R. 341-342). Moreover, they can receive no income from the pledged collateral which they hold since, by orders entered on July 26, 1933, and September 26, 1933, respectively, the District Court authorized the Debtor's Trustees to refrain from paying the interest due on the Short Line bonds (R. 22) and on the Debtor's First and Refunding bonds. Cf. *Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398, 445 (1934).

Moreover, mortgaged real estate is always in the possession of the bankrupt and hence, by the terms of the Act, comes under the exclusive jurisdiction of the bankruptcy court. The commencing in any other court of a suit to foreclose a lien on such property would inevitably interfere with the exclusive jurisdiction of the bankruptcy court, assumed prior to the institution of the foreclosure suit. *Straton* v. *New*, 283 U. S. 318, 321 (1931); *Ex Parte Baldwin*, 291 U. S. 610 (1934). Validly pledged securities, however, are not in the possession of the bankrupt at the time of filing the bankruptcy petition and hence do not pass into the control and custody of the bankruptcy court. The pledgee does not need to seek the aid of that court, or any other court, to realize on the pledged collateral, and his act in so doing cannot constitute an interference with the exclusive jurisdiction of the bankruptcy court or with its administration of the bankrupt's estate.

It is true that under Section 77 (l), p. 92, *infra*, the court is given the right to stay pending suits against the Debtor, but, as this clause does not purport to cover enforcement proceedings, such as sales, which do not involve judicial action, it is not necessary to consider the validity of such provision.

For the foregoing reasons, it is respectfully submitted that Section 77, as construed and applied by the court below, deprives petitioners of their property in violation of the Fifth Amendment.

IV.

Practical considerations affecting the decision of this Court.

The questions presented are of unusual importance for they affect the basis upon which literally hundreds of millions of dollars of now outstanding collateral loans were made,[21] and, if the decision of the court below stands, banks and business houses generally will have to revise the entire theory and technique of such loans.

In recent years, lenders of money have hesitated to make loans for long terms, so that present day borrowings are primarily for short terms and are largely obtained by the use of securities and collateral. In such transactions, the borrower is able to secure the requisite funds with despatch by the pledge of his securities; the lender is protected by the collateral pledged, and, most important of all, his loan *is liquid* by reason of his right to realize quickly upon the collateral, if necessary.

Until the decision below, neither insolvency nor bankruptcy of the borrower has interfered with the lender's right to realize promptly upon the pledged collateral. The public policy involved in this rule of law is stated in *In re*

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[21] On October 17, 1934, the total outstanding loans of member banks in the Federal Reserve System secured by stocks and bonds was $4,178,000,000 (Federal Reserve Board Bulletin for December, 1934, p. 789). Since loans by member banks of the System constitute about 60% of the total bank loans (see *ibid.*, p. 790), it would seem that the total collateral loans presently outstanding by banks and business houses generally is in excess of $6,000,000,000, of which apparently less than $1,000,000,000 are brokers' loans (see *ibid.*, 791; see also Federal Reserve Board Weekly Report, dated January 7, 1935). Large amounts of such collateral consist of secured obligations of the borrower. See Hatch, "A Form of Depression Finance—Corporations Pledging Their Own Bonds," 47 Harv. L. Rev. 1093.

Hudson River Navigation Corporation, 57 F. (2d) 175 (C. C. A. 2d, 1932), *supra*, as follows (p. 176):

> "* * * Millions of dollars are daily lent upon like collateral, which fluctuates from hour to hour; unless the pledgee is free to choose his time to sell, his security may disappear. * * * The pledgee, having taken possession of the documents, supposes himself for just that reason to be the sole judge of his necessities, and lends on that understanding."

Within the last two years Congress has greatly enhanced the scope of the Bankruptcy Act. By Section 77 the Act is made applicable to inter-state railroads, and, by Section 77-B (Act of June 7, 1934; U. S. C. A., Title 11, Sec. 207), to corporations generally, including public utilities and intra-state railroads. As a result of the new provisions, nearly every borrower of money upon pledged collateral is in a position voluntarily and without notice to creditors to subject himself or itself to the jurisdiction of a bankruptcy court.

While the decision in the instant case applies only to a proceeding under Section 77, and, in a strict sense, only to a case where the pledged collateral consists of bonds of the pledgor, there can be no doubt but that such decision will be held generally applicable to proceedings under Section 77-B (see comparative table of jurisdictional provisions in petitioners' petition for certiorari, pp. 32-33), and to pledged collateral of all kinds (see *In re White Truck & Transfer Co.* (S. D. Cal.), decided Sept. 4, 1934).

If the lender of money upon collateral is to be subject to the hazard of being prevented from realizing on the

pledge by an injunction, with the consequent freezing of his short term loan into a long term loan for an indefinite period, it is not unlikely that the lender will either (a) refuse to lend the money at all, or (b) require a much greater margin of security. In either event, the result will be a sharp tightening of credit at a time when Congress and the Administration are earnestly endeavoring to accomplish the opposite result.

Considerations such as these tend strongly, we submit, to indicate that Congress did not intend that Section 77 should have the effect ascribed to it by the courts below. (See comment of Senate Judiciary Committee with respect to subdivision (h) of Section 74, enacted at the same time as Section 77, S. Rept., No. 1215, 72d Cong., 2 Sess., p. 5, p. 47, *supra*).

The court below stated (R. 323) that "we are justified in giving to the amendment a liberal construction." With this we agree. But it is one thing to construe the statute liberally and another thing to "construe" it by "balancing equities" between different classes of creditors, especially when such construction (a) is based upon abstractions and generalities not predicable upon any provision of the statute, and (b) results in overturning a long line of cases reaching a contrary result.

The court below apparently believed that the District Court possessed authority to issue the injunction because (a) it would be of benefit to the other creditors, and (b) it would not harm petitioners. Thus, the court stated (R. 324-325):

> "The controversy was restricted to a restraining of the immediate pursuit of a remedy by the cred-

> itors *in order that a plan might be presented which would take care of appellants' claims in full* but without special and irreparable injury to other creditors • • • less fortunate in the amount and character of their security.
>
> • • • • • •
>
> "Appellants have received and will probably continue to receive the prompt payment of interest upon their claims • • •. *Balancing equities,* we find the court wisely sought to protect the great mass of debtor's creditors *without injuring the position of appellants* • • •."

We reject the theory that the jurisdiction of the court could be determined by "balancing equities." But even on this theory, the court below proceeded under *serious misapprehension of the facts.*

Contrary to the court below (R. 325), petitioners have received no interest whatever on their loans since the injunction was entered (R. 341-342). Indeed, the avowed purpose of the injunction was to enable the debtor to discontinue interest payments without any risk of a sale of the collateral (R. 43; also, R. 13-14, 19-20, 29, 316). In addition to the principal amount of the loans, interest is now due and owing to petitioners in the approximate amount of $310,000.

Nor is there any basis for the statement that the injunction was necessary "in order that a plan might be presented which would take care of appellants' claims in full." Putting aside the fact that no plan was before the court when the statement was made and the fact that none has since been formulated, there was nothing before the court (and in the nature of things there could not be) from which it could properly assume that any plan to be hereafter consummated would take care of petitioners' claims in full.

As for the court's statement (R. 325) that the injunction did not injure petitioners, it has already been pointed out that (based on last prior sales on the New York Stock Exchange) the market value of the pledged collateral held by petitioners has declined more than $1,700,000 between the date when the debtor's petition for an injunction was filed and the present time (see p. 12, *supra*), with the result that the petitioners' loans, which possessed a margin of security when the debtor's petition was filed, are *now* seriously under-margined.

These serious misapprehensions under which the court below labored serve further to demonstrate, we believe, the error of the court's approach to both the questions of construction and those of constitutionality which were before it.

V.

The District Court was without jurisdiction to issue an injunction against the non-resident banks.

The petitioners in Nos. 481 to 484, inclusive, 487 and 488, *i. e.*, the non-resident banks, contend that the District Court was without jurisdiction to issue the injunction as to them for reasons wholly apart from those hereinbefore discussed.

The non-resident banks not only were not parties to the proceedings in the District Court, but were not then and are not now residents of or doing business in the Northern District of Illinois. The bonds which they hold as collateral for notes of the Debtor and the notes themselves are held by said banks, and the notes are payable, at the respective places of business of said banks in New York City and St. Louis (R. 52-55, 116-119, 319).

Upon these facts, the District Court clearly would have been without authority in an ordinary bankruptcy proceeding to issue an injunction against the non-resident banks.

Section 2 of the Bankruptcy Act, as amended, provides (p. 91, *infra*) that—

> "• • • courts of bankruptcy • • • are hereby invested, *within their respective territorial limits* as established • • •, or as they may be hereafter changed, with such jurisdiction • • •."

Since the territorial limits imposed by Congress upon the district courts are thus expressly made applicable to courts of bankruptcy (*Robertson* v. *Railroad Labor Board*, 268 U. S. 619, foot-note at pp. 624-625 (1925)), it follows that even though such courts have jurisdiction over the property of the bankrupt *"wherever situated"* (see p. 85, *infra*), they are without authority to exercise a jurisdiction *in personam* beyond their territorial limits. Accordingly, a bankruptcy court sitting in one district is without authority to enjoin a person in another district, over whom it has no personal jurisdiction, from doing any act wholly outside the territorial limits of the court.[22] *Acme Har-*

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[22] This is in accordance with the general rule that a decree of injunction operates *in personam* and will not issue against a person not within or subject to the jurisdiction of the Court. *Chase National Bank* v. *City of Norwalk*, 291 U. S. 431 (1934); *Scott* v. *Donald*, 165 U. S. 107, 117 (1897); *Clarke* v. *Boysen*, 39 F. (2d) 800, 815 (C. C. A. 10th, 1930), cert. den. 282 U. S. 869 (1930); *Guaranty Trust Co.* v. *Fentress*, 61 F. (2d) 329, 333 (C. C. A. 7th, 1932).

Cf. Section 19 of the Act of October 15, 1914, c. 323, 38 Stat. 738 (U. S. C. A., Title 28, Sec. 383), which provides that:

> "Every order of injunction or restraining order • • • shall be binding only upon the parties to the suit, their officers, agents, servants, employees, and attorneys, or those in active concert or participating with them, • • •."

Cf. also Section 57 of the Judicial Code (U. S. C. A., Title 28, Sec. 118); *General Investment Co.* v. *Lake Shore Ry.*, 260 U. S. 261, 279-280 (1922); *Chase* v. *Wetzlar*, 225 U. S. 79, 88-89 (1912).

vester Co. v. *Beekman Lumber Co.*, 222 U. S. 300, 310, 311 (1911); *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 738 (1931); *Progressive Building & Loan Co.* v. *Hall*, 220 Fed. 45 (C. C. A. 4th, 1914); *Staunton* v. *Wooden*, 179 Fed. 61, 63-64 (C. C. A. 9th, 1910); *In re J. & M. Schwartz*, 204 Fed. 326, 328-329 (E. D. N. Y., 1913); see also *In re Ohio Copper Mining Co.*, 241 Fed. 711 (S. D. N. Y., 1917); *In re Geller*, 216 Fed. 558 (D. N. J., 1914).

Assuming that the District Court would have been without authority to issue an injunction against the non-resident banks upon the facts in this case in an ordinary bankruptcy proceeding (R. 320), the court below held that Section 77 had "extended the court's jurisdiction over the debtor's property so as to include the *entire United States*" (R. 322), and that, therefore, it could issue a decree *in personam* against said banks even though they were not within, and held the pledged collateral beyond, the geographical limits of the District Court. This conclusion is plainly erroneous.

As previously stated (p. 36, *supra*), Section 77 (n) expressly provides that, *unless changed by Section 77*, and unless inconsistent therewith, the jurisdiction and powers of the court in a proceeding under that section shall be *those possessed by the court in an ordinary voluntary bankruptcy proceeding.*

There is, however, nothing in Section 77 which expressly or by implication makes the limits of the court "co-extensive with the territorial boundaries of the United States" (R. 322), or which gives to a court proceeding under that section a wider jurisdiction *in personam* or a wider jurisdiction over property pledged by the debtor than is possessed by a bankruptcy court generally. In fact, the contrary appears.

The provision upon which the court below relied is Section 77 (a), which provides in part (p. 92, *infra*) that—

> "The petition shall be filed with the court in whose *territorial jurisdiction* the railroad corporation, • • • has had its principal • • • office, • • •. If the petition is so approved, the court • • • shall, • • • *have exclusive jurisdiction of the debtor and its property wherever located.*"

The particular phrase relied upon ("exclusive jurisdiction of the debtor and its property wherever located") follows a sentence in which the words "territorial jurisdiction" are unmistakably used to refer to the *geographical limits of the judicial district*, and does not expressly or by necessary implication make the jurisdictional limits of the District Court "coextensive with the territorial boundaries of the United States," or extend the court's jurisdiction "so as to include the entire United States" (see R. 322).

In terms, the court is given exclusive jurisdiction of (a) "the debtor," and (b) "its property wherever located." This language may be given full effect without "interpreting" it as by *implication* (a) amending the statute fixing the territorial limits of the District Court, or (b) giving the court a wider jurisdiction of the debtor's property, or (c) giving the court a wider jurisdiction *in personam* with respect to creditors of the debtor, than is possessed by a bankruptcy court generally with respect to property and creditors of the bankrupt.

To make effective the grant of exclusive jurisdiction over the "debtor," there is no reason why the court must be deemed to be sitting as a bankruptcy court throughout the entire United States, or why the court must be deemed

to have *personal jurisdiction* over all *creditors of the debtor* wherever found. The filing of a petition under Section 77 in a district court is a *caveat* to all other courts (*cf. Mueller* v. *Nugent*, 184 U. S. 1, 14 (1902)), and it no doubt follows that thereafter no other court may independently entertain proceedings by or against the debtor in the absence of authority from the former court. See *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734 (1931).

Similarly, to make effective the grant of exclusive jurisdiction over the debtor's "property wherever located" there is no reason why the court must be deemed to be sitting as a bankruptcy court, with all the powers of such, in every place where property in which the debtor is interested may be found or where creditors of the debtor may be located.[23]

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[23] To sustain the decision of the court below as to the non-resident banks, it is necessary to construe Section 77 as doing more than merely changing the legal situs of the pledged bonds. Even if Section 77 be deemed to change the legal situs of the pledged bonds held by the non-resident banks (see *Guaranty Trust Co.* v. *Fentress*, 61 F. (2d) 329 (C. C. A. 7th, 1932)) and to give such bonds a legal situs within the Northern District of Illinois, the District Court would still be without authority to issue an injunction against said banks.

A court does not acquire jurisdiction to proceed personally against one over whom it has no personal jurisdiction merely because property of such person is found within the geographical limits of the court. Under proper *statutes*, a court may attach a non-resident's property and proceed by publication against such non-resident in so far as any judgment rendered can be satisfied out of the property. Such a proceeding is a *quasi in rem* action and does not permit the court to render a personal judgment against such a non-resident. *Pennoyer* v. *Neff*, 95 U. S. 714 (1877). Since an injunction operates *in personam*, it cannot be predicated upon a *quasi in rem* jurisdiction. See *Skinner* v. *Ed. Pict. Sec. Corp.*, 129 Atl. 857 (Del. Ch., 1925); *Beale, "The Jurisdiction of Courts over Foreigners,"* 26 Harv. L. Rev. 283, 297.

By the grant of exclusive jurisdiction over the debtor's property "wherever located," Section 77 may, perhaps, impliedly prevent *any other court* from *independently* entertaining proceedings with respect to such property, even as to property not in the custody or control of the court in which the debtor's petition is filed. The district court in which the petition has been filed would, however, still retain "exclusive" jurisdiction of the debtor's property wherever located even though, in order to deal with property not actually or constructively in the debtor's possession, and not within the territorial limits of the district, it may have to direct the institution (by the debtor or its trustee) of legal proceedings in another jurisdiction. In other words, the court's jurisdiction over the debtor's property is not rendered non-exclusive merely because situations may arise in which, because of limitations (a) upon that court's jurisdiction *in personam*, and (b) over property not in its possession, it may have to seek the aid of another district court in order to reach persons who are not before it and property which is not in its possession. See *Carpenter* v. *International-Great Northern R. Co.*, 5 F. Supp. 768 (S. D. Tex., 1933), *supra*.

Convincing proof of the meaning of the phrase "exclusive jurisdiction of the debtor and its property wherever located" is found—as has been brought out in another connection (p. 40, *supra*)—in repeated decisions of this and other courts wherein the jurisdiction of a bankruptcy court with respect to the person and property of the bankrupt has been defined in language *practically identical with that of the phrase in question.*

Thus, in *Gross* v. *Irving Trust Co., supra,* this Court said (p. 344):

> "Upon adjudication of bankruptcy, title to all the property of the bankrupt, *wherever situated*, vests in the trustee * * *. The bankruptcy court has *exclusive jurisdiction*, * * *."

Likewise, in *Isaacs* v. *Hobbs Tie & Timber Co.*, *supra*, the Court stated (p. 737):

> "* * * all property owned and possessed by the bankrupt vests in the trustee * * * *no matter whether situated within or without the district in which the court sits.* * * * the bankruptcy court has *exclusive jurisdiction* to deal with the property of the bankrupt estate."

The use by Congress, in fixing the jurisdiction of the court over the person and property of the debtor in a proceeding under Section 77, of language identical with that employed over a long period of years by this Court in describing the jurisdiction of a bankruptcy court over the person and property of a bankrupt, is altogether persuasive, if not conclusive, evidence that Congress intended that such jurisdictions should be the same. (See cases cited at p. 41, *supra*.)

By statutory provision of long standing and rarely departed from, "the jurisdiction of a district court *in personam* has been limited to the district of which the defendant is an inhabitant or in which he can be found" and, "It is not lightly to be assumed that Congress intended to depart from a long established policy." *Robertson* v. *Railroad Labor Board*, 268 U. S. 619, 627 (1925); *General Investment Co.* v. *Lake Shore Railway*, 260 U. S. 261 (1922). Accordingly, had it been the intent of Congress to make the territorial limits of the court, in a proceeding under

Section 77, coterminous with the entire nation, or to give the court jurisdiction over all *creditors of the debtor* wherever found, it must be presumed that apt language to such effect would have been employed. In the past, when Congress has intended that the jurisdiction *in personam* of a district court should be exercised beyond its geographical limits, it has indicated such intention in unmistakable terms.[24]

Further proof that Section 77 does not evidence the legislative intent ascribed to it by the courts below is found in the absence of any provision in Section 77, or elsewhere, creating a mechanism for the functioning of a court with nation-wide territorial limits. By Section 2 of the Bankruptcy Act, as amended (p. 91, *infra*), wide powers are conferred upon a bankruptcy court. By Section 77 (n) these powers, so far as consistent with Section 77, are conferred upon the court in a proceeding under that section. If it had been intended by Congress that such powers could be asserted *anywhere in the United States*, it is reasonable to assume that Congress would have provided that the process of the court might run into every part of the United States. (Cf. *Toland* v. *Sprague*, 12 Pet. 300, 328 (1838); *Staunton* v. *Wooden*, 179 Fed. 61, 64 (C. C. A. 9th, 1910).) Such a power is indispensable if the court is to be able to enforce decrees *in personam* against persons who are not within the limits of the district in which the court is sitting.

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[24] See the Act of March 3, 1873, c. 226, §4, 17 Stat. 485, 509; Act of July 2, 1890, c. 647, §§4, 5, 26 Stat. 209, 210 (U. S. C. A., Title 15, Secs. 4 and 5); Act of Sept. 19, 1922, c. 345, 42 Stat. 849 (U. S. C. A., Title 28, Sec. 112).

The court below placed reliance upon the fact that Section 77 "was intended to • • • exclude ancillary receivership proceedings in bankruptcy cases wherein railroad corporations were the bankrupts" (R. 322). But this fact contradicts rather than sustains the decision below.

In essence, the goal of Section 77 was to make possible the reorganization of railroads, many of whom were in financial distress, on a more uniform, efficient and less expensive basis than such reorganizations had been carried out in the past. To this end, Congress provided for a reorganization *in bankruptcy* such as theretofore had been possible only in *an equity receivership*, but with certain restrictions (*e. g.*, requiring the approval of any plan of reorganization by the Interstate Commerce Commission, etc.) not applicable to equity receiverships.[25]

One object of this device was to obviate costly and cumbersome *ancillary receiverships* (see p. 35, *supra*). Such ancillary receiverships are necessary in interstate railroad receiverships because an equity receiver is without title to, and the court without jurisdiction over, property beyond the territorial limits of the court. *Great Western Mining Co.* v. *Harris*, 198 U. S. 561, 577 (1905); *Sterrett* v. *Second Nat'l Bank*, 248 U. S. 71, 76, 77 (1918). A bankruptcy court, however, *unlike a receivership court*, has always had jurisdiction of the bankrupt's property *wherever situated*, and accordingly, ancillary bankruptcy proceedings *in the nature of ancillary receivership proceedings* are seldom if

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[25] See H. Rept. No. 1897, 72nd Cong. 2d Sess., p. 5; 76 Cong. Rec., pp. 2917, 2923, 4880, 5106-5107, 5108, 5128, 5356, 5359; *Lansdown* v. *Faris*, 66 F. (2d) 939, 940-941 (C. C. A. 8th, 1933).

ever necessary,[26] although in order to reduce the bankrupt's property to possession from persons who are not before it, a bankruptcy court may have to seek the aid of a foreign

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[26] Ancillary receiverships in equity are independent of the principal receivership (*Coltrane* v. *Templeton*, 106 Fed. 370 (C. C. A. 4th, 1901); *Shinney* v. *North American Savings, Loan & Bldg. Co.*, 97 Fed. 9 (C. C., D. Utah, 1899); cf. *Mitchell* v. *Maurer*, No. 54, Present Term); and all jurisdictional requirements must be satisfied (*Central R. R. & Banking Co. of Ga.* v. *Farmers' Loan & Trust Co. of N. Y.*, 56 Fed. 357 (S. D. Ga., 1893)). Accordingly, a proceeding for the appointment of an ancillary receiver must be instituted by a creditor in that jurisdiction. The receiver appointed in the principal receivership cannot petition *ex parte* for an ancillary receivership (*In re Brant*, 96 Fed. 257 (S. D Cal., 1899); cf. *Mitchell* v. *Maurer*, No. 54, Present Term; *Greene* v. *Star Cash & Package Car Co.*, 99 Fed. 656 (C. C., D. Conn., 1900)). Moreover, the ancillary court is under no compulsion to conform its proceedings to those of the principal court, and if it believes that such action would prejudice the resident creditors in the ancillary jurisdiction, it will refuse to do so (*Coltrane* v. *Templeton*, 106 Fed. 370 (C. C. A. 4th, 1901); *Shinney* v. *North American Savings, Loan & Bldg. Co.*, 97 Fed. 9 (C. C., D. Utah, 1899); *Guarantee Trust and Safe Deposit Co.* v. *Philadelphia R. & N. E. R. Co.*, 69 Conn. 709 (1897)).

Ancillary receiverships in equity are thus really *ancillary administrations*, as distinguished from exercises of ancillary jurisdiction in aid of a single court administering a bankrupt's assets. It was these independent proceedings, unknown in bankruptcy, which Section 77 was intended to eliminate. But the purpose to eliminate these ancillary administrations with the attendant appointment of an ancillary trustee or trustees, does not indicate an intent to give the court in a proceeding under Section 77 a territorial jurisdiction wholly at variance with the ordinary bankruptcy court.

An ancillary proceeding in bankruptcy is in no sense an *independent proceeding*, but is invoked by the trustee appointed by the bankruptcy court having the administration of the bankrupt's estate, and is strictly incidental to and in aid of the latter court. See *Lazarus* v. *Prentice*, 234 U. S. 263, 267 (1914). Whether such ancillary jurisdiction shall be invoked rests within the discretion of the bankruptcy court approving the petition in bankruptcy. In so far as a bankruptcy court wishes to assert jurisdiction *in personam* over persons outside its territorial limits, it may and must, through its trustee, invoke the ancillary jurisdiction of a court whose jurisdiction *in personam* reaches such person. This, however, in no way interferes with the "exclusive jurisdiction" of the bankruptcy court to administer the *entire estate* of the bankrupt, "wherever situated," free from interference by *other courts*.

court (see cases, p. 81, *supra*). The manifest purpose of Congress, therefore, in using the language in question was to make it clear that in railroad reorganization proceedings under the Bankruptcy Act, unlike railroad reorganizations in equity receiverships, the court should have the same exclusive control over the debtor railroad and its property as is possessed by a bankruptcy court in an ordinary bankruptcy (*i. e.*, liquidation) proceeding.[27]

But, while Congress intended to eliminate ancillary reorganization proceedings *as such*, with the attendant appointment of ancillary "receivers," it did not declare that the territorial limits of the court should be co-extensive with the United States; nor did it declare that the process of the court might run anywhere in the United States; nor did it give the court such a jurisdiction as necessarily to imply an intent to do either of these things. Just as a bankruptcy court in an ordinary bankruptcy proceeding, though having *"exclusive jurisdiction"* of the bankrupt and his property *"wherever situated,"* is remitted to proceedings by the trustee in a foreign jurisdiction where such step is necessary in order to compel or prevent action by one over whom it has no personal jurisdiction (p. 81, *supra*), so the bankruptcy court in a proceeding under Section 77 is of necessity remitted to similar action in order to accomplish a similar end.

Present day business is conducted with little regard for intervening state or other lines. If a district court may, in a proceeding under Section 77, issue an injunction

[27] See remarks of Senator Hastings, sponsor of the bill in the Senate (76 Cong. Rec., p. 4880). It is of some significance that in *Ex Parte Baldwin*, 291 U. S. 610 (1934), which involved the jurisdiction of a bankruptcy court in a proceeding under Section 77, the Court clearly indicated that ancillary proceedings, in aid of the primary court's administration of the estate, may be necessary (see pp. 614, 615).

against a creditor of the debtor *anywhere in the United States*, merely upon notice by mail, all creditors of the debtor must submit themselves to the jurisdiction of that court, although such creditors may be residents of New York and the bankruptcy proceedings may be pending in California, or else must assume the risk of court action adverse to their interests. If Congress had intended to impose such new and severe burdens upon banks and business houses, and to create a court with a jurisdiction so unlike that of other courts, it seems clear that language would have been used which would leave no doubt as to the legislative intent.

Conclusion.

The judgments of the Circuit Court of Appeals should be reversed, and the causes remanded to the District Court with instructions to vacate the injunctional order of November 22, 1933 (R. 104), and so much of subdivision (8) of the order of June 7, 1933 (R. 7) as denies to petitioners the right to dispose of the pledged collateral held by them pursuant to the terms of the Debtor's notes.

Respectfully submitted,

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APPENDIX.

Statutes Involved.

Section 2(15) of the Bankruptcy Act (Act of July 1, 1898, c. 541, §2(15), 30 Stat. 545, as amended; U. S. C. A., Title 11, §11(15)):

> "The courts of bankruptcy * * * are hereby invested, within their respective territorial limits as established, on July 1, 1898, or as they may be thereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings, to * * * (15) make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this Act."

Section 57(h) of the Bankruptcy Act (Act of July 1, 1898, c. 541, §57(h), 30 Stat. 560, as amended; U. S. C. A., Title 11, §93(h)):

> "(h) The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance."

Section 67(d) of the Bankruptcy Act (Act of July 1, 1898, c. 541, §67(d), 30 Stat. 564, as amended by Act of June 25, 1910, c. 412, §12, 36 Stat. 842; U. S. C. A., Title 11, §107(d)):

> "(d) Liens given or accepted in good faith and not in contemplation of or in fraud upon the provi-

sions of this Act, and for a present consideration, * * * shall, to the extent of such present consideration only, not be affected by anything herein."

Section 77(a) of the Bankruptcy Act (Act of March 3, 1933, c. 204, §1, 47 Stat. 1474; U. S. C. A., Title 11, §205(a)):

"(a) Any railroad corporation may file a petition stating that the railroad corporation is insolvent or unable to meet its debts as they mature, and that it desires to effect a plan of reorganization. * * * Upon the filing of such a petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that such petition complies with this section and has been filed in good faith, or dismissing it if not so satisfied. If the petition is so approved, the court in which such order approving the petition is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located. * * *"

Section 77(l) of the Bankruptcy Act (Act of March 3, 1933, c. 204, §1, 47 Stat. 1474; U. S. C. A., Title 11, §205(l)):

"(l) In addition to the provisions of section 11 of this Act for the staying of pending suits against the debtor, such suits shall be further stayed until after final decree (and)[29] the judge may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree."

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[29] The word "and" in parentheses was omitted from the statute and is supplied as required to make sense.

Section 77(n) of the Bankruptcy Act (Act of March 3, 1933, c. 204, §1, 47 Stat. 1474; U. S. C. A., Title 11, §205(n)):

> "(n) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Section 74(m) of the Bankruptcy Act (Act of March 3, 1933, c. 204, §1, 47 Stat. 1467, as amended June 7, 1934, c. 424, §2, 48 Stat. 922, 923; U. S. C. A., Title 11, §202(m)):

> "(m) The filing of a debtor's petition or answer seeking relief under this section shall subject the debtor and his property, wherever located, to the exclusive jurisdiction of the court in which the order approving the petition or answer as provided in subdivision (a) is filed, and this shall include property of the debtor in the possession of a trustee under a trust deed or a mortgage, or a receiver, custodian or other officer of any court in a pending cause, irrespective of the date of appointment of such receiver or other officer, or the date of the institution of such proceedings: Provided, That it shall not affect any proceeding in any court in which a final decree has been entered * * *."

Section 74(n) of the Bankruptcy Act (Act of March 3, 1933, c. 204, §1, 47 Stat. 1467; U. S. C. A., Title 11, §202(n)):

> "(n) In addition to the provisions of section 11 of this Act for the staying of pending suits, the court, on such notice and on such terms, if any, as it deems fair and equitable, may enjoin secured creditors who may be affected by the extension proposal from proceeding in any court for the enforcement of their claims until the extension has been confirmed or denied by the court."